Banc Ceannais na hÉireann
Central Bank of Ireland
Eurosystem

Central Bank of Ireland Contracts for Difference Intervention Measure

pursuant to Article 42 of Regulation (EU) No 600/2014 of the European Parliament and of the Council

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Introduction: Central Bank of Ireland Contracts for Difference Intervention Measure

Introduction

1. In recent years, the Central Bank of Ireland (Central Bank) has increased its focus on the sale of speculative products to retail clients, including:

    a. conducting thematic reviews in relation to contracts for difference (CFDs),
    b. publishing a consultation paper setting out its concerns in relation to CFDs and outlining proposed measures aimed at protecting the interests of retail clients (CP 107), and
    c. working closely with the European Securities and Markets Authority (ESMA) on its work on CFDs, binary options and other speculative products.

2. On 27 March 2018, the Central Bank issued a warning to investors on CFDs and binary options. The Central Bank has previously highlighted the risks associated with these speculative products and has published European Securities and Markets Authority (ESMA) warnings about CFDs, binary options and other speculative products in 2013 and 2016.

3. The Central Bank has significant investor protection concerns from the sale of CFDs to retail clients. The Central Bank's concerns stem from the complexity and lack of transparency of these products, their excessive leverage, the disparity between the expected return and the risk of loss, the level of sophistication of investors and issues relating to their marketing and distribution. The Central Bank considers that restrictions on the sale of CFDs to retail clients is necessary and proportionate to address its significant concerns about the risk to investors from these products.

4. Due to EU-wide concerns about investor protection in relation to these products, 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). The initial ESMA CFD Measure applied from 1 August 2018 for a three-month period

and was subsequently renewed by ESMA for further three month periods[1]. The Central Bank supported ESMA's CFD Measure and the subsequent renewals.[2]

5. The Central Bank has worked closely with ESMA in developing the ESMA CFD Measure and in its assessment of the conditions in Article 40(2) of Regulation (EU) No 600/2014 of the European Parliament and of the Council of 15 May 2014 on markets in financial instruments and amending Regulation (EU) No 648/2012 (MiFIR). The ESMA CFD Measure was designed to address the significant investor protection concerns caused by the sale of CFDs to retail clients.

The Central Bank CFD Measure

6. The Central Bank is now putting in place the Central Bank CFD Measure to restrict the sale, marketing and distribution of CFDs to retail clients in or from Ireland. These measures will come into effect upon the expiry of the temporary ESMA CFD Measure and ensure the continued protection of retail clients by the Central Bank.

7. The Central Bank CFD Measure relates to CFDs that are cash settled derivative contracts, the purpose of which is to give the holder an exposure, which can be long or short, to fluctuations in the price, level or value of an underlying asset. These CFDs include, inter alia, rolling spot forex products and financial spread bets. The Central Bank CFD Measure does not relate to options, futures, swaps, and forward-rate agreements.

8. Warrants and turbo certificates are not in scope of the Central Bank CFD Measure. Securitised derivatives that are CFDs are not excluded from the definition of CFDs. CFDs that offer leveraged exposure to price, level or value changes in underlying asset classes have existed as a speculative short-term investment product

[1] See Decision (EU) 2018/796, Decision (EU) 2018/1636, Decision (EU) 2019/155 and Decision (EU) 2019/679.

[2] ESMA's first product intervention decisions in relation to contracts for difference and binary options is 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-contracts

provided to a niche client base in some jurisdictions for several years. However, in recent years, a large number of National Competent Authorities (NCAs) have raised concerns about the widening distribution of CFDs to a mass retail market, despite these products being complex and inappropriate for the large majority of retail clients. On the basis of information gathered by the Central Bank, ESMA and other NCAs, an increase has been observed in the levels of leverage being offered in such products to retail clients and in the levels of client losses arising from investing in these products. Prior to the ESMA CFD measure, the Central Bank had observed leverage levels of 400:1 offered to retail clients with minimal experience of trading CFDs. In other European jurisdictions, leverage levels of up to 500:1 had been observed.

Legislative basis and compliance with Article 42 of MiFIR

9. MiFIR introduced product intervention powers under which the Central Bank may prohibit or restrict the marketing, sale or distribution of certain financial instruments or a type of financial activity or practice in or from Ireland.

10. Commission Delegated Regulation (EU) 2017/567 of 18 May 2016 supplementing Regulation (EU) No 600/2014 of the European Parliament and of the Council with regard to definitions, transparency, portfolio compression and supervisory measures on product intervention and positions (Delegated Regulation) specifies certain criteria and factors to be taken into account by NCAs in determining when there is a significant investor protection concern.

11. Article 42(5) of MiFIR requires the Central Bank to publish on its website notice of any decision to impose a prohibition or restriction referred to under Article 42(1) of MiFIR. This notice must specify:
    - details of the prohibition or restriction,
    - a time after the publication of the notice from which the measures will take effect, and
    - the evidence upon which the Central Bank is satisfied each of the conditions in Article 42(2) are met.

12. In accordance with Article 42(5) of MiFIR, Part A of this notice sets out the evidence upon which each of the conditions in Article 42 (2)

of MiFIR are met in relation to the Central Bank CFD Measure. The Central Bank CFD Measure is set out at Part B of this notice.

13. Directive 2014/65/EU of the European Parliament and the Council of 15 May 2014 on markets in financial instruments and amending Directive 2002/92/EC and Directive 2011/61/EU (recast) is transposed into Irish law by the European Union (Markets in Financial Instruments) Regulations 2017 (SI No.375 of 2017) (the MiFID Regulations).

14. For the avoidance of doubt, terms used in the Central Bank CFD Measure have the same meaning as in Directive 2014/65/EU, including the definition of derivatives.

PART A

Evidence upon which each of the conditions in Article 42 (2) of MiFIR are met in relation to the Central Bank CFD Measure

15. 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.

16. The Central Bank conducted a thematic inspection of CFD providers in 2011. That inspection noted that losses to retail clients when trading CFDs can be significant and that firms were failing to inform and provide adequate warnings to consumers of the risks involved. Low levels of compliance with the relevant consumer protection requirements were broadly observed within the industry.

17. A follow-up thematic inspection of CFD providers was carried out by the Central Bank in 2015. This inspection found that 75% of retail CFD clients who invested in CFDs during 2013 and 2014 made a loss, of which the average loss was €6,900. It was observed that retail clients generally were not sufficiently aware of the high risk and complex nature of the product. The Central Bank concluded that CFDs are not suitable for investors who have a low risk appetite due to the volatile nature of the CFD market, coupled with the potential for the consumer to lose more than the initial investment.

18. A recent follow-up review by the Central Bank of a sample of the largest CFD providers in Ireland found that in the two-year period up to 31 December 2016, 74% of retail clients lost money with an average loss of €2,700. Studies of client data conducted in other European jurisdictions have found similarly high levels of client losses.

19. ESMA has also undertaken significant work in relation to the sale of CFDs to retail clients across the EU. The Central Bank has actively contributed to and supported this important ESMA work, which is summarised in this Part of this notice.

20. The Central Bank CFD Measure puts in place product intervention measures on a national basis, the substance and scope of which

reflect the ESMA CFD Measure, which applies on a temporary basis across the EU. The Central Bank assessment of the conditions in Article 42(2) of MiFIR set out in this Part draws on the evidence and analysis gathered by ESMA in assessing its compliance with the conditions in Article 40(2) of MiFIR, in addition to the evidence gathered and analysis undertaken by the Central Bank. This includes the evidence and analysis set out in:

a. the ESMA CFD Measure, which sets out evidence from all EU Member States in relation to the sale of CFDs to retail clients on a cross-border basis; and
b. ESMA's *Product Intervention Analysis Measures on Contracts for Differences* (ESMA 50-162-215).

21. The assessment set out in the following sections is based on the Central Bank's own supervisory experience, and the substantial evidence gathered by other NCAs and ESMA over recent years.

The existence of a significant investor protection concern

Article 42(2)(a) of MiFIR

22. Article 42(2)(a) of MiFIR states that the Central Bank may take the action referred to in Article 42(1) if it is satisfied on reasonable grounds that a financial instrument, structured deposit or activity or practice gives rise to significant investor protection concerns. In determining whether there exists a significant investor protection concern, the Central Bank has assessed the relevance of the criteria and factors listed in Article 21(2) of the Delegated Regulation. After taking the relevant criteria and factors into consideration, the Central Bank has concluded that there is a significant investor protection concern for the reasons set out below.

The degree of complexity and transparency of CFDs

Article 21(2)(a) of the Delegated Regulation

23. CFDs are complex products[3], typically not traded on a trading venue. The pricing, trading terms, and settlement of such products is not standardised, impairing retail clients' ability to understand the terms of the product. In addition, CFD providers often require clients to acknowledge that the reference prices used to determine the value of a CFD may differ from the price available in the respective market where the underlying asset is traded, making it difficult for retail clients to check and verify the accuracy of the prices received from the provider.

24. The costs and charges applicable to trading in CFDs are complex and lack transparency for retail clients. In particular, retail clients typically find it difficult to understand and assess the expected performance of a CFD, also taking into account the complexity arising from the impact of transaction fees on such performance. Transaction fees in CFDs are normally applied to the full notional value of the trade and investors consequently incur higher transaction fees relative to their invested funds at higher levels of leverage. Transaction fees are usually deducted from the initial margin deposited by a client and high leverage can lead to a situation where the client, at the moment of opening a CFD, observes a significant loss on their trading account which is caused by the application of high transaction fees. Since transaction fees at higher leverage will erode more of the client's initial margin, clients will be required to earn more money from the trade itself to realise a profit. This lowers the client's chances of realising a profit net of transaction fees, exposing clients to a greater risk of loss.

25. In addition to transaction fees, spreads and various other financing costs and charges may be applied[4]. These include commissions (a general commission or a commission on each trade, or on opening and closing a CFD account) and/or account management fees. Financing charges are also usually applied to keep a CFD open, such as daily or overnight charges, to which a mark-up can also be added. The number and complexity of the various costs and charges and their impact on clients' trading performance contribute to the lack

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[3] CFDs do not meet the criteria to be regarded as non-complex financial instruments according to the combined reading of Article 25(4) of Directive 2014/65/EU and Article 57 of the Commission Delegated Regulation (EU) 2017/565 of 25 April 2016 supplementing Directive 2014/65/EU of the European Parliament and of the Council as regards organisational requirements and operating conditions for investment firms and defined terms for the purposes of that Directive (OJ L 87, 31.3.2017, p. 1).

[4] A spread quoted by a CFD provider to retail clients may include a mark-up to the market prices the provider faces from an external source, such as a liquidity provider.

of sufficient transparency in relation to CFDs in order to enable a retail client to make an informed investment decision.

26. Another complexity arises from the use of stop loss orders. This product feature may give retail clients the misleading impression that a stop loss order guarantees execution at the price which they have set (the level of the stop loss). However, stop loss orders do not guarantee a protection level but the triggering of a 'market order' when the CFD price reaches the price set by the client. Accordingly, the price received by the client (execution price) can be different from the price at which the stop loss was set[5]. While stop losses are not unique to CFDs, leverage increases the sensitivity of an investor's margin to price movements of the underlying asset increasing the risk of sudden losses and means that traditional trading controls such as stop losses are insufficient to manage investor protection concern.

27. Another key complexity associated with CFDs may arise from the relevant underlying market. For instance, with FX trading, clients speculate on one currency against another. If neither of these currencies is the currency used by the client to open a CFD position, any return received by the client will be dependent on the measures taken by the client to assess the movement of these three currencies. This suggests that a high level of knowledge of all the currencies involved is required to successfully navigate the complexities of such currency trading. Retail clients rarely have such knowledge.

28. CFDs with cryptocurrencies as an underlying asset raise separate and significant concerns. Cryptocurrencies are a relatively immature asset class that pose major risks for investors. The Central Bank has warned consumers about the risks of buying or investing in cryptocurrencies[6]. For CFDs on cryptocurrencies, many of these concerns remain present. This is because retail clients typically do not understand the risks involved when speculating on an extremely volatile and relatively immature asset class, which are exacerbated by trading on margin, as it requires clients to react in a very short time period.

[5] See also Article 19(2)(d) of Delegated Regulation (EU) 2017/567 and, in particular, the last sub-factor listed therein, that is the use of inter alia terminology that implies a greater level of security than that which is actually possible or likely or which imply product features that do not exist.

[6] https://www.centralbank.ie/consumer-hub/consumer-notices/consumer-warning-on-virtual-currencies

The particular features or components of CFDs

Article 21(2)(e) of the Delegated Regulation

29. The main feature of CFDs is their ability to operate on leverage. In general, whilst leverage can increase the possible profit for clients, it can also increase the possible losses. The Central Bank has observed leverage levels of 400:1 offered to retail clients with minimal experience of trading CFDs. Other NCAs have noted that leverage levels applied to CFDs across the EU range from 3:1 to 500:1.[7] As far as retail clients are concerned, the application of leverage may increase the probability of a larger loss to a greater extent than the probability of a larger gain for the reasons set out below. Leverage affects an investment's performance by increasing the impact of transaction fees incurred by retail clients.

30. Another risk related to trading in leveraged products is linked to the interaction of high leverage and the practice of automatic margin close-out. Under commonly applied contractual terms, CFD providers are granted the discretion to close-out a client's account once the client's net equity reaches a specified percentage of the initial margin that the client is required to pay in order to open a CFD position(s).

31. The interaction between high leverage and automatic margin close-out is that it increases the probability that a client's position will be closed automatically by the CFD provider in a short timeframe or a client has to post additional margin in the hope of turning around a losing position. High leverage increases the probability that the client has insufficient margin to support their open CFDs by making the client's position(s) sensitive to small fluctuations in the price of the underlying asset to the client's disadvantage.

32. It has been observed that in market practice, margin close-out appears to have been introduced by CFD providers mainly to allow them to more easily manage client exposures and the provider's credit risk by closing out a client's position before the client had insufficient funds to cover their current exposure[8]. Automatic

[7] See ESMA CFD Measure, recital 21
[8] See ESMA CFD Measure, recital 25

margin close-out also provides a degree of protection for clients as it reduces, but does not eliminate, the risk that the client (particularly at high levels of leverage) loses all or more than their initial margin.

33. Some NCAs reported to ESMA that the level at which automatic margin close-out is applied is inconsistent across CFD providers[9]. CFD providers with clients who typically trade at lower value order sizes, and who typically act as direct counterparty to the clients' trades, have previously set the margin close-out rule between 0 and 30 % of initial margin required. By eroding the client's funds close to 0, the provider is placing the client at increased risk of losing more money than they had invested.

34. A related risk of leverage is that it places clients at risk of losing more money than they have invested. This is a key risk which retail clients may not understand, even despite written warnings. The margin posted by a client is posted as collateral to support the client's position. If the price of the underlying asset, for example, moves against the client's position in excess of the initial margin posted, the client can be liable for losses in excess of the funds in their CFD trading account, even after the closure of all their other open CFD positions. Some NCAs had reported to ESMA that a number of retail clients lost significant sums of money during the de-pegging of the Swiss Franc in January 2015.[10]

35. Trading at high leverage levels also increases the impact of 'gapping' during periods of significant market volatility. Gapping occurs when there is a sudden movement in the price of the underlying asset. Gapping is not unique to CFDs, but the risks related to such events are exacerbated by high leverage. If gapping occurs, the client on the losing side may be unable to close an open CFD at their preferred price and can result in significant client losses when trading at high leverage. In the case of the Swiss franc shock in 2015 for example, this has led to retail clients losing significantly more than the sum initially invested[11].

[9] ESMA CFD Measure, recital 26
[10] ESMA CFD Measure, recital 27
[11] See an example where an investor lost EUR 280 000 with only EUR 2 800 invested. Available at: https://www.bafin.de/SharedDocs/Veroeffentlichungen/EN/Pressemitteilung/2016/pm_161208_allgvfg_cfd_en.html

36. The often high levels of leverage offered to retail clients, the volatility of certain underlying assets, together with the application of transaction costs which impact the investment's performance, can result in rapid changes to a client's investment position. This results in the client having to take swift action to manage the risk exposure by posting additional initial margin to avoid the position being automatically closed out. In such instances, high leverage can lead to large losses for retail clients over a very short time span and exacerbates the risk that clients will lose more than the funds paid to trade CFDs.

The size of potential detrimental consequences and the degree of disparity between returns for investors and the risk of loss

Article 21(2)(b) and (f) of the Delegated Regulation

37. In the ESMA CFD Measure, ESMA set out evidence that indicated that the number of retail clients investing in CFDs as well as the number of providers offering these products across the European Union had grown up until the date of the first ESMA CFD measure.

38. The ESMA CFD Measure set out that specific studies carried out by the following NCAs into investor outcomes for retail clients investing in CFDs show that a majority of retail clients in these EU Member States investing in these products lost money from trading:

    a) CY-CySEC conducted analysis of a sample of retail client accounts (approximately 290,000 client accounts) of 18 major CFD providers for the period from 1 January 2017 to 31 August 2017. It found that on average, 76% of client accounts made an overall loss over that particular period, with around 24% of client accounts in profit. On average, the loss per account was around EUR 1,600;

    b) the Comisión Nacional del Mercado de Valores (‘ES-CNMV’), the Spanish NCA, found that approximately 82% of retail clients have lost money overall in a 21-month period between early 2015 and late 2016. The average loss per retail client was EUR 4,700;

c) the Autorité des marchés financiers ('FR-AMF'), the French NCA, found that more than 89% of retail clients lost money overall over a 4-year period from 2009 to 2013, and that the average loss per retail client was EUR 10,887. In addition, data provided by the FR-AMF from the office of the Ombudsman in France identified that the average overall loss per annum for complainants of CFDs was EUR 15,207 in 2016. Furthermore, the Ombudsman noted that, particularly in 2016 and 2017, the practices of regulated providers became even more aggressive and increasingly targeted investors likely to make significant payments. Several complaints regarding incidents of harassment and manipulation were from applicants with substantial savings. Figures for 2016 mediations before the French Ombudsman appear to support this, with the average amount recovered increasing to EUR 11,938 and half of all cases concerning an amount above EUR 5,000. The losses incurred by some investors topped EUR 90,000, and the cumulative losses in cases handled on the merits, that is involving authorised companies, exceeded EUR 1 million. The FR-AMF also found that retail clients who trade the most (by number of trades, average trade size or cumulative volume) lose the most. The same applies to those who continue trading over time, indicating there is no learning curve;

d) the Hrvatska agencija za nadzor financijskih usluga ('HR-HANFA'), the Croatian NCA, carried out a loss-per- client study for one Croatian investment firm offering CFDs to its clients. The study assessed 267 retail clients' losses or gains for the trading period from January to September 2016. HR-HANFA found that total client losses for the period was approximately EUR 1,017,900, while total retail client gains were approximately EUR 420,000;

e) the Central Bank, carried out a thematic review in 2015 which showed that 75% of retail clients trading CFDs during 2013 and 2014 suffered losses with the average loss amongst those clients being EUR 6,900. A follow-up review of a sample of the largest CFD providers in Ireland found that in the 2-year period from 2015 to 2016, 74% of retail clients lost money with an average loss of EUR 2,700;

f) the work of the Commisione Nazionale per le Società e la Borsa ('IT-CONSOB'), the Italian NCA, conducted during 2016 has shown that in 2014-2015, 78% of the Italian retail clients of a specific CFD provider lost money investing in CFDs and 75% lost money investing in rolling spot forex, with the average loss being EUR 2,800. It was also found that there is a positive correlation between the number of trades carried out by retail clients and the amount of losses suffered. A subsequent survey conducted for IT-CONSOB in March 2017 on five Italian branches of providers operating in CFDs found that in 2016 retail client losses were up to 83% with the average loss per client of approximately EUR 7,000;

g) the Komisja Nadzoru Finansowego ('PL-KNF'), the Polish NCA, conducted in Q1 2017 a study based on the data provided by 10 investment firms offering CFDs (based on 130,399 client accounts of which 38,691 were active accounts) and concluded that 79.28% of the clients lost money in 2016. The average result was a loss per client of PLN 10,060. Moreover, a similar study conducted by PL-KNF in Q1 2018 based on the data provided by seven investment firms offering CFDs in Poland in 2017 (177,883 client accounts, of which 40,209 were active accounts) showed that 79.69% of the clients lost money in 2017. The average result was a loss per client of PLN 12,156 in 2017. The percentage of active clients losing money amounted to 81% (2012), 81% (2013), 80% (2014), 82% (2015), 79% (2016) and 80% (2017);

h) a study carried out by the Commission de Surveillance du Secteur Financier ('LU-CSSF'), the Luxembourgish NCA, stated in September 2017 that from two LU-CSSF authorised providers of CFDs, the average losses per retail client were EUR 4,500 and approximately EUR 1,700;

i) an analysis carried out by the UK-FCA in 2014 on a sample of non-advised retail client accounts from 8 CFD providers, suggested that 82% of retail clients lost money on these products and that the average outcome was a loss of GBP 2,200 per retail client over a year. Information received during the UK-FCA's December 2016 consultation process also found a correlation between higher leverage levels, and increased probability and size of losses. A further study by the UK-FCA in 2016/2017 in relation to advisory and discretionary services provided for CFDs over a 12-month period found further evidence of poor outcomes for retail clients. The review found that within the population of firms offering CFDs on an advisory and discretionary services, 76% of retail clients lost money, experiencing an average loss of GBP 9,000. Even when the profitable retail clients were taken into consideration, on average, a typical retail client investing under an advisory and discretionary managed account lost around GBP 4,100;

j) the Comissãdo Mercado de Valores Mobiliários (PT-CMVM), the Portuguese NCA, found that on a notional value of investors' position of EUR 44,700 million in 2016 and EUR 44,200 million in 2017, the associated losses for retail clients were EUR 66.8 million and EUR 47.7 million for the years 2016 and 2017 respectively.

39. In addition, a study was carried out by the Finanstilsynet ('NO-Finanstilsynet'), the Norwegian NCA, on the trading results of 6 CFD providers' clients in 2016. The study included approximately 1,000 retail clients trading in CFDs over 1 to 2 years commencing in January 2014 and ending between December 2014 and December 2015 (on average a trading period of 1.5 years). It showed that 82% of those clients lost money with an average loss per client of EUR 29,000. The average transaction costs relative to a client's equity was 37% (due to high leverage and frequent trading).

40. The Central Bank notes the consistent pattern of average losses for retail clients in CFDs over time and across countries comes despite positive returns for retail clients in other financial products in many of the years in question. The percentage of retail clients losing money in the AMF study referred to in recital 35(iii) in each year from 2009 to 2013 is remarkably consistent, despite varying annual returns in stock market and commodity indices over the same period, for example. The Central Bank's evidence is also consistent on the level of retail clients who have lost money on CFDs (74-75%). The persistence of the pattern of losses for retail clients in CFDs indicates a structural feature of the return profile, in contrast to positive historical returns on (long term) investments in other financial products such as equity investment funds. These studies paint a stark picture of the significant investor protection concern raised by the offer of these CFDs to retail clients.

The type of clients involved in a financial activity or financial practice

Article 21(2)(c) of the Delegated Regulation

41. CFDs are marketed, distributed or sold to both retail and professional clients. However, retail (unlike professional) clients do not normally possess the experience, knowledge and expertise to make investment decisions which properly assess the risks they incur with regard to the complex CFDs that are restricted by the Central Bank CFD Measure.

42. The Central Bank notes that one study in a Member State[12] has indicated that the highest maximum leverage levels were often offered to retail clients, whilst professional clients and eligible counterparties were offered lower maximum leverage levels. Given the evidence of losses observed by ESMA and the Central Bank in retail client accounts described in the above paragraphs, it is clear that a significant investor protection concern exists in respect of the unrestricted marketing, distribution or sale of CFDs to this category of client.

Marketing and distribution activities in relation to CFDs

Article 21(2) (j) of the Delegated Regulation

43. The Central Bank notes that although CFDs are complex products, they are offered to retail clients most commonly via electronic trading platforms, without the provision of investment advice or portfolio management. An assessment of appropriateness is required in such cases pursuant to Regulation 33 (3) and (4) of the MiFID Regulations[13]. However, this assessment does not prevent CFD providers or their clients or potential clients proceeding with a transaction, subject to a simple warning to the client. This can occur where the client has provided no or insufficient information to the provider as to their knowledge and experience in the investment field relevant to the specific type of product as well as where the provider has concluded that the product is not appropriate for the

[12] See recital 40 ESMA CFD Measure: A study on the offer of CFDs and rolling spot forex to retail clients was conducted by the MT-MFSA
[13] Article 25(3) of Directive 2014/65/EU

client. This enables retail clients to access products, such as CFDs, which, by their features, should not be distributed to them.

44. The Central Bank found, as part of its thematic inspection published in 2015, that the criteria used for assessing appropriateness varied among firms. Although some firms went over the requirements, the Central Bank determined that in others, the client's knowledge and experience may have been overestimated[14].

45. The UK-FCA observed repeated failings by the approach of CFD providers to completing the appropriateness assessment, including inadequacies in the assessment itself, inadequate risk warnings to retail clients who failed the appropriateness assessments and lack of establishment of a process to assess whether clients who fail the appropriateness assessment, but who nonetheless wish to trade CFDs, should be allowed to proceed with CFD transactions. Revisiting this issue in late 2016, the UK-FCA found that a significant number of firms had failed to address these failings following the previous feedback provided to them.

46. Furthermore, NCAs have voiced concerns about CFD providers' compliance with their obligations to give clients clear and not misleading information, or act in the best interests of clients. NCAs have also voiced concerns regarding the inadequate performance of appropriateness tests in practice and inadequate warnings to clients when they fail the appropriateness test. Examples of these bad practices are described in and gave rise to ESMA's Questions and Answers relating to the provision of CFDs and other speculative products to retail clients under MiFID.

47. NCAs have also observed aggressive marketing practices as well as misleading marketing communications in this sector of the market. They include, for example, the use of sponsorship arrangements or affiliations with major sports teams, which give the misleading impression that complex and speculative products such as CFDs are suitable for the retail mass market by promoting general brand name awareness. Furthermore, they also included the use of misleading statements such as 'Trading has never been so easy', 'Start your

[14] https://www.centralbank.ie/docs/default-source/regulation/consumer-protection/compliance-monitoring/themed-inspections/stockbroking-investment-firms/gns4-2-1-2-info-rel-rev-cntrcts-diff1115.pdf?sfvrsn=4

career as a trader right now', 'Earn GBP 13 000 in 24 Hours! Get started'.[15]

48. In the context of the development of the ESMA CFD Q&As, some NCAs had reported to ESMA that CFD providers often fail to adequately disclose the risks of these products. In particular, some NCAs found that CFD providers did not adequately describe the potential for rapid losses that could exceed their invested funds.

49. Also in this context, some NCAs have also raised concerns about the 'churning' nature of some CFD providers' business models[16]. Because the average life span of a client account can be relatively short, this can place a certain pressure on providers to maintain a steady stream of new clients, which could incentivise providers to adopt aggressive marketing and sales techniques that are not in the retail client's best interests.

50. A common feature of marketing and sales techniques adopted by the CFD industry has been the offer of trading (monetary and non-monetary) benefits, such as bonuses to attract and encourage retail clients to invest in CFDs, the offer of gifts (for example holidays, cars, electronic goods), trading tutorials or reduced costs (for example spread or fees)[17].

51. Bonuses and other trading benefits can act as a distraction from the high-risk nature of the product. They are typically targeted to attract retail clients and incentivise trading. Retail clients can consider these promotions as a central product feature to the point they may fail to properly assess the level of risks associated with the product.

52. Furthermore, such trading benefits to open CFD trading accounts often require clients to pay funds to the provider and conduct a specified number of trades over a specified period of time. Given that the evidence demonstrates that the majority of retail clients lose money trading CFDs, this often means that clients lose more money from trading CFDs more frequently than they otherwise would have without receiving a bonus offer.

[15] See ESMA CFD Measure Recital 44
16 See ESMA CFD Measure Recital 46
[17] Section 6 of the ESMA Questions and Answers (Q&As) relating to the provision of CFDs and other speculative products to retail clients under MiFID (ESMA-35-36-794) as updated on 31 March 2017 states that it is unlikely that a firm offering a bonus that is designed to incentivise retail clients to trade in complex speculative products such as CFDs, CFDs and rolling spot forex could demonstrate that it is acting honestly, fairly and professionally and in the best interests of its retail clients.

53. Supervisory work by several NCAs has discovered that the terms and conditions on promotional offers are often misleading and that many clients were unaware of the conditions to access the benefits/bonuses offered. Finally, a number of clients reported difficulties in withdrawing funds when trying to use such bonuses.[18]

54. In addition to the factors outlined above, many NCAs observe that distribution models observed in this sector of the market bear certain conflicts of interest. The pressure to maintain a pipeline of new clients increases the potential for conflicts of interest to occur. Conflicts of interest have and may arise from the fact that some CFD providers are counterparties to clients' trades without hedging their exposure, therefore placing their interests in direct conflict with that of their clients. For these providers there is a greater risk and incentive to manipulate or use less transparent reference prices, or to pursue other questionable practices such as cancelling profitable trades on spurious pretexts. There is also a risk that providers may seek to exploit asymmetric slippage (for example pass on any loss as a result of slippage to the client, while retaining any profit obtained as a result of slippage). Providers may purposefully delay the time between quotes and execution of CFD trades to further exploit this practice. NCAs have also identified practices whereby CFD providers apply an asymmetrical or inconsistent mark up to core spreads.[19]

55. The Central Bank has considered the evidence above, and has concluded that, in the absence of the restrictions, such as those contained in the temporary ESMA CFD Measure, the sale of CFDs to retail clients gives rise to significant investor protection concerns.

Applicable existing regulatory requirements under European Union law do not sufficiently address the significant investor protection concern identified

Article 42(2)(b) of MiFIR

56. As required under Article 42(2)(b) of MiFIR, the Central Bank has considered whether existing regulatory requirements in the EU that are applicable to the relevant financial instrument or activity do not

[18] See ESMA CFD Measure Recital 50
[19] See ESMA CFD Measure Recital 51

address the threat. The Central Bank has considered the applicable existing regulatory requirements set out in the MiFID Regulations, MiFIR and Regulation (EU) No 1286/2014 of the European Parliament and of the Council (the PRIIPs Regulation). In particular, they include: (i) the requirement to provide appropriate information to clients in Regulation 32 (3) to (9) of the MiFID Regulations[20]; (ii) the suitability and appropriateness requirements in Regulation 33 (3) to (4) of the MiFID Regulations[21]; (iii) the best execution requirements in Regulation 35 of the MiFID Regulations[22]; (iv) the product governance requirements in Regulation 23 (1) (b) to (e)[23] of the MiFID Regulations and Regulation 32 (1) to (2)[24] ; and (v) the disclosure requirements in Articles 5 to 14 of the PRIIPs Regulation.

57. The Central Bank considers that existing regulatory requirements do not sufficiently address the significant investor protection concern arising from the features of CFDs, and the evidence from ESMA and other NCAs of high levels of losses among retail clients.

58. The Central Bank has considered the disclosure requirements set out in the PRIIPs Regulation and concluded that the PRIIPs disclosure requirements do not sufficiently draw retail clients' attention to the consequences of investing in CFDs. In particular, the PRIIPs disclosure requirements do not provide the client with the overall percentage of retail client accounts that lose money when trading CFDs with a particular firm as a stand-alone disclosure, which the Central Bank considers is an effective and focused disclosure, particularly in an online environment.

59. CFDs qualify as complex financial products and therefore are subject to the appropriateness test pursuant to Regulation 33 (3) of the MiFID Regulations[25]. In relation to the appropriateness requirements under the MiFID Regulations, the Central Bank's supervisory experience has demonstrated that the appropriateness test has not been sufficient to address the investor protection concern described in the notice[26]. CFD trading mostly occurs via

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[20] Article 24(3) and (4) of Directive 2014/65/EU
[21] Article 25(2) and (3) of Directive 2014/65/EU
[22] Article 27 of Directive 2014/65/EU
[23] Article 16(3) of Directive 2014/65/EU
[24] Article 24(2) of Directive 2014/65/EU
[25] Article 25(3) of Directive 2014/65/EU
[26] The Central Bank has previously expressed concerns on the criteria used to assess knowledge and experience for the purposes of the assessment following our themed inspection on CFDs. https://centralbank.ie/docs/default-source/news-and-media/press-releases/press-release-archive/press-releases-2015-jul-dec.pdf#page=192

electronic platforms, without the provision of investment advice or portfolio management, and therefore the MiFID suitability requirements do not apply. The Central Bank concludes that both the suitability and appropriateness tests under the existing regulatory requirements therefore are unlikely to prevent retail clients from trading CFDs in a way that ensures that the significant investor protection concerns are addressed.

60. The Central Bank has considered whether the best execution rules could address at least some of the concerns identified in relation to the marketing, distribution or sale of CFDs to retail clients and has concluded that the best execution rules by themselves do not address the risks linked to the product's features, other than execution, and to the wide marketing, distribution or sale of these products to retail clients.

61. In relation to product governance requirements, the Central Bank has concluded that these requirements do not address the key risks described in the Central Bank CFD Measure linked to the product's features (for example high leverage) or associated practices (for example, allowing additional payment obligations or the offer of bonuses). They also do not require specific and uniform restrictions on the distribution of CFDs. Instead, the detriment to clients shows that the marketing, distribution or sale of CFDs is not appropriate for the retail mass market, unless accompanied by certain restrictions which the product governance requirements do not detail.

62. Despite the existence of these regulatory requirements, evidence showed that retail clients continued to lose money on CFDs. Therefore, this measure is necessary to address the threat.

The issue would not be better addressed by improved supervision or enforcement of existing requirements

Article 42(2)(b) of MiFIR

63. Article 42(2)(b) requires that the significant investor protection concern identified would not be better addressed by improved supervision or enforcement of existing requirements. On 6 March

2017, the Central Bank issued a consultation paper which sought views on two main options: (i) the prohibition of the sale or distribution of CFDs to retail clients, or (ii) the implementation of enhanced investor protection measures, including a limitation on leverage and a requirement that retail clients cannot lose more than the amount they had deposited on a per-position basis.

64. As outlined at the outset of Part A of this notice, 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.

65. Prior to adopting the ESMA CFD Measure, ESMA took a number of non-binding actions in relation to the significant investor protection concerns identified in relation to the sale of CFDs to retail clients. ESMA has carried out supervisory convergence work and has coordinated the work of a Joint Group established to tackle issues related to a number of providers offering binary options, CFDs and other speculative products to retail clients on a cross-border basis across the EU. ESMA had repeatedly noted the risks of CFDs in investor warnings, Questions and Answers and its opinion on 'MiFID practices for firms selling complex products'[27]. Despite ESMA's extensive use of its non-binding instruments to ensure a consistent and effective application of the applicable existing regulatory requirements, the investor protection concerns persisted[28]. This highlights that, for the reasons set out in this section, these requirements did not address the concerns identified.

66. On 18 January 2018, ESMA launched a call for evidence on its potential product intervention measures on the marketing, distribution or sale of CFDs and binary options to retail clients[29] (the 'call for evidence'). The call for evidence closed on 5 February 2018. ESMA received almost 18,500 responses. Based on a full consideration of the responses, and all other relevant evidence, ESMA considered it necessary to impose a temporary restriction on the marketing, distribution or sale of CFDs to retail clients in accordance with Article 40 (1) of MiFIR.

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[27] Opinion on MIFID practices for firms selling complex financial products of 7 February 2014 (ESMA/2014/146).
[28] ESMA CFD Measure, recital 67.
[29] Call for evidence on potential product intervention measures on contracts for differenceand binary options to retail clients (ESMA35-43-904).

67. ESMA adopted the ESMA CFD Measure under Article 40 of MiFIR. This decision came into effect on 1 August 2018 for a period of 3 months. The measure was since renewed. The ESMA measure is an existing regulatory requirement, but will have expired before our domestic measure should come into place.

The action is proportionate taking into account the nature of the risks identified, the level of sophistication of investors or market participants concerned and the likely effect of the action on investors and market participants who may hold, use or benefit from the financial instrument, structured deposit or activity or practice

Article 42(2)(c) of MiFIR

68. Taking into account the size and nature of the significant investor protection concern identified, the Central Bank considers it necessary and proportionate to restrict the marketing, distribution or sale of CFDs to retail clients to circumstances where a number of conditions are met.

69. The Central Bank CFD Measure addresses the significant investor protection concern identified by affording an appropriate and uniform level of minimum protection to retail clients trading CFDs.

The main benefits linked to the Central Bank CFD Measure are:

(i) reduction of the mis-selling risk of CFDs and its related financial consequences. This is a major benefit for retail clients and for the financial markets as a whole;

(ii) restoring investors' confidence in financial markets including confidence in providers active in this sector which may have suffered from reputational damage arising from problems encountered by investors.

70. In terms of the financial consequences and costs that providers will face when implementing the intervention measures set out in the Central Bank CFD Measure, it should be noted that the requirements of the ESMA CFD Measure, have been in place across

the EU since 1 August 2018. The Central Bank CFD Measure will apply those same requirements in Ireland.

Initial margin protection

71. The Central Bank considers it necessary to restrict the marketing, distribution or sale of CFDs to retail clients by the application of certain specific leverage limits depending on the nature of the underlying asset.

72. The leverage limits set out in the Central Bank CFD Measure is designed to protect retail clients by requiring them to pay a minimum initial margin in order to enter into a CFD. This requirement is known as 'initial margin protection'. This will limit the retail client's notional investment exposure in relation to the amount of money invested. As the costs a client faces are increasing in notional investment exposure, initial margin protection will reduce the probability of client losses compared to those that would be expected if the client were to trade at higher leverage[30]. As further explained below, empirical academic research corroborates this analysis and establishes that leverage limits improve average outcomes for investors[31].

73. Existing research indicates that lower leverage is associated with improved client outcomes, including lower losses per trade and lower total transaction fees as a function of lower volumes of trading[32].

74. In addition, requiring minimum initial margin addresses some of the distribution risks relating to CFDs by ensuring that only retail clients who are capable of posting sufficiently high margin can trade in these products.

75. Relatedly, the initial margin protection is also designed to lower the likelihood that CFD providers target a mass retail client market

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[30] The higher the leverage, the more likely client losses are because spreads and fees make up a larger proportion of the initial margin. Higher leverage also makes it more likely that a client will lose a given percentage of the margin, increasing the risk of material detriment to the investor. See Recital 91 of the ESMA CFD Measure

[31] Should Retail Investors' Leverage Be Limited? Rawley Z. Heimer and Alp Simsek. NBER Working Paper No 24176, issued in December 2017 and available at: https://papers.ssrn.com/sol3/papers.cfm?abstract_id=2150980

[32] See, Heimer, Rawley, and Simsek, Alp, Should Retail Investors' Leverage Be Limited? NBER Working Paper No 24176, issued in December 2017 and available at: https://papers.ssrn.com/sol3/papers.cfm?abstract_id=2150980

through smaller account sizes, supported by higher leverage. It is intended to encourage firms to focus on sophisticated retail clients and professional clients, rather than 'churning' less sophisticated retail clients. The proposed initial margin protection will therefore help ensure that CFD providers act on terms that are in the best interests of their clients instead of seeking to attract new clients or to expand market share through higher levels of leverage.

76. The initial margin protection will also help address the risk of potential conflicts of interest particularly when CFD providers do not hedge their clients' trades and so benefit directly from client losses, by reducing the risk of firms profiting from losing client trades and expected profits from trading.

ESMA analysis in determining leverage limits

77. The initial margin protection for each underlying asset has been set according to the volatility of that underlying asset using a simulation model to assess the likelihood of a client losing 50 % of their initial investment over an appropriate holding period[33]. The levels set in the Central Bank CFD Measure are the same as those set by ESMA. In that regard, ESMA undertook a quantitative simulation of the distribution of returns an investor in a single CFD might expect to receive at different leverage levels. The starting point of the simulation was approximately 10 years of daily market price data (in most cases) for various underlying asset types commonly used in CFDs sold to retail clients. For the purpose of the analysis, ESMA considered a CFD that is automatically closed out if the margin reaches 50 % of its initial value. The simulated probability with which close-out occurs depends on (and is increasing in) the given leverage. A metric examined was the probability of (automatic) close-out as a function of leverage. This metric allows for leverage limits to be set according to a model that is expected to address detriment on a consistent basis across different underlying asset types.

78. ESMA considered that, given the retail nature of investors and statistics on the distributions of CFD holding periods (using data collected by NCAs) it was appropriate to set initial margin protection by assuming retail clients hold an asset for at least 1 day. To provide a consistent reference point, ESMA then simulated what leverage

[33] ESMA CFD Measure, recital 102

would lead to margin close-out with a 5 % probability, for different underlying assets. The range of results within each asset class then informed the selection of leverage limits. In most cases, the limits were set conservatively towards the lower end of the range. Consideration was given to how widely traded different assets are. For example, among CFDs on commodities, oil and gold are both commonly traded by retail clients, but simulations indicate that the leverage implying a 5 % probability of margin close-out for CFDs in gold is around twice that of CFDs in oil. The leverage limit for CFDs in gold is accordingly different to that for oil and other commodities. Determining initial margin protection in this way, in particular through simulated positions lasting at least 1 day, provides a consistent and necessary level of protection for retail clients who may not actively monitor their position over the course of a trading day or may not be able to assess the need for quick reactions in light of the volatility of the underlying market. In the case of CFDs on equities, data suggest that holdings are typically longer than for other assets, and consideration was given to holding periods of up to 5 days.

79. In developing the ESMA CFD Measure, ESMA considered alternative approaches to the calibration of the initial margin protection. For example, an alternative would be to set a single leverage limit for all CFDs irrespective of their underlying asset. However, ESMA considered it appropriate to distinguish between different underlying asset types given differences in historic price volatility between different classes of underlying asset, in addition to differences in typical fee structures within the current CFD firm population[34] and typical client behaviour.

Margin close-out protection

80. Another measure to protect retail clients is the margin close-out protection. This measure complements the introduction of initial margin protection and mitigates the risk of retail clients losing

[34] The cost assumptions used were based on cost data from CFD providers. The cost assumptions were varied as part of robustness checks, which did not lead to material changes in the results. This does not indicate that spreads, fees and charges are not a source of material detriment in general, especially at high leverage. Indeed, these costs are a key reason that a majority of retail clients lose money and a source of substantial losses for clients who trade many positions frequently. Rather, the robustness checks simply indicate that typical spreads, fees and charges do not make close-out substantially more likely under the assumptions used. In the modelling exercise, a single CFD position was simulated in all cases. See ESMA CFD Measure, recital 104

significant funds in excess of the funds they have invested in a CFD, under normal market circumstances.

81. The provision of a margin close-out protection and the standardisation of the percentage at which CFD providers are required to close-out a client's open CFD (at 50 % of the initial required margin) is also designed to address the inconsistent application of margin close-out practices by CFD providers that have been observed by NCAs prior to the ESMA CFD Measure and documented in the ESMA CFD Measure. The ESMA CFD Measure sets out that some NCAs have observed that CFD providers allow their clients' funds to fall to 0 – 30 % of the initial margin required to open a CFD By allowing clients to erode their margin close to zero, providers are placing clients at risk of losing more than their deposited funds particularly during a gapping event. Conversely, a level of margin close-out which is too high would expose clients to being frequently closed out which might not be in their interest. The 50 % threshold set out in the CFD measure mitigates the risk of substantial loss by retail clients and is therefore proportionate.

82. The ESMA CFD measure discusses two possibilities: margin close out on a per position or a per account basis. ESMA originally proposed the application of a margin close-out rule at 50 % of initial margin on a per position basis to provide an effective protection for retail clients while also reducing the complexity of the product, and with improving retail clients' understanding of their exposure.

83. ESMA conducted analysis on expected investor outcomes according to whether a margin close-out rule was applied per position (a CFD will be closed out when its value falls below 50 % of the value of the initial margin) or per CFD trading account (a CFD will be closed out when the value of all open CFDs connected with the trading account together with all funds in that account falls below 50 % of the value of the total initial margin for all those open CFDs). In particular, it assessed the frequency of close-out and the impact of crystallising clients’ losses for a simulated portfolio of CFD positions under each scenario. This analysis did not estimate precise numerical outcomes, reflecting that there is an extremely large range of different potential portfolios that an investor could hold. Instead, the analysis considered whether either of the two bases would be expected in general to lead to better outcomes for investors. The general conclusion was that the better investor outcome for a position or account basis of margin close-out depends on the price movements

of the underlying assets of the CFDs in investment portfolios. The reason for this is that following a close-out which would happen on one basis but not the other, the price of an underlying asset may recover or may deteriorate.

84. ESMA's analysis indicated that, in general, the difference in outcomes resulting from the per position basis versus the per account basis is expected to be small for many investors (but cannot be precisely quantified in the absence of a representative portfolio). ESMA noted some responses to its call for evidence which highlighted additional reasons why an account basis may be better for some investors. Firstly, in allowing gains from one position to offset losses from another, an account basis supports a diverse portfolio of investments. Secondly, to the extent close-out happens less frequently on an account basis, it reduces the scope for investors to bear costs arising from re-entering positions.

85. Based on the assessment outlined above, ESMA considered a standardised margin close-out rule per account basis at 50 % of the total initial margin protection, as an individual measure to take in addition to the other measures described in the Central Bank CFD Measure, was proportionate as a minimum protection to be applied. In particular, this rule is designed to provide for close-out of one or more CFDs on terms most favourable to the retail client to ensure that the value of the account does not fall lower than 50 % of the total initial margin protection that was paid to enter into all currently open CFDs at any point in time. The value of the account for these purposes should be determined by the funds in that account together with any unrealised net profits from open CFDs connected to that account.

86. The margin close-out protection on a per account basis does not prevent a provider from applying a per position close-out rule at 50% of the initial margin requirement of the specific position instead of a per account close-out rule; indeed this could reduce the complexity for retail clients. Furthermore, by applying a per position close-out rule at 50 %, the provider inherently fulfils the close-out requirement on a per account basis as all the single positions will be closed in accordance with the 50 % close-out rule.

Negative balance protection

87. The negative balance protection aims at protecting retail clients in exceptional circumstances where there is a price change in the underlying asset that is sufficiently large and sudden to prevent the CFD provider from closing out the position as required by the margin close-out protection, such that the client has a negative account value. In other words, large market events can cause gapping, preventing the automatic margin close-out protection from being effective. The ESMA CFD Measure set out that a number of NCAs[35] had observed that, following such events, clients have owed considerably more than they invested, ending up with a negative balance on their CFD trading account.

88. The purpose of a negative balance protection is to ensure that an investor's maximum losses from trading CFDs, including all related costs, are limited to the total funds related to trading CFDs that are in the investor's CFD trading account. This should include any funds yet to be paid into that account due to net profits from the closure of open CFDs connected to that account. An investor should not incur any additional liability connected with its trading of CFDs. Other accounts should not be part of the investor's capital at risk. In case a trading account also includes other financial instruments (for example, UCITS or shares), only the funds explicitly dedicated to CFD trading, and not those dedicated to other financial instruments, are at risk.

89. The purpose of the negative balance protection is also to provide a ‘backstop’ in case of extreme market conditions. ESMA conducted analysis of the Swiss franc event in January 2015 to consider its direct impact on investors across a number of scenarios[36]. These scenarios were the following:

i. protection against any negative balance on a CFD trading account held by a retail client;
ii. protection against any negative balance on each CFD position held by a retail client; and

[35] For example, DE-BaFin stated that some investors lost more money than they invested due to the decision of the Swiss National Bank to no longer peg the Swiss Franc to the Euro. Available at: https://www.bafin.de/SharedDocs/Veroeffentlichungen/EN/Aufsichtsrecht/Verfuegung/vf_170508_allgvfg_cfd_wa_en.html
[36] ‘Swiss franc event’ refers to the sudden appreciation in the Swiss franc against the euro, of the order of 15 %, on the morning of Thursday, 15 January 2015.

iii. no negative balance protection.

90. In assessing these options, ESMA noted that the direct impact on investors resulting from the different options in the case of extreme market events needed to be weighed against the resulting ongoing costs of providing this protection. In particular, CFD providers would face ongoing costs attributable to additional capital or hedging, as part of their risk management. Some portion of these costs could in turn be passed through to investors themselves in the form of higher spreads or other charges.

91. On the other hand, an important risk of major consumer detriment that arises in the absence of negative balance protection is the potential for an investor to owe money to a firm as a result of extreme market conditions. Such a situation is especially detrimental for investors without considerable liquid wealth[37]. ESMA decided to adopt negative balance protection per CFD trading account as the way to address this source of potential major detriment while minimising associated costs to firms and investors. In particular, ESMA considered that the imposition of a negative balance protection per each CFD would have risked imposing disproportionate costs on investors and firms. If a negative balance protection per position were introduced, firms would be required to forgive any losses by the client in excess of the funds dedicated to that position, including initial margin and any additional margin paid by the client. As negative balance protection would not enable the netting of a significant loss with other positions in a client's portfolio, a per position rule would increase the market risk assumed by firms. This would likely result in an increase of the capital requirements for firms, the costs of which would likely be passed on to retail clients.

92. The Central Bank has considered the effects on CFD providers for providing negative balance protection as well as the substantial detriment to retail clients, which can arise without this protection. The Central Bank considers that, on balance, negative balance protection on an account basis addresses the investor protection concern identified and is proportionate.

[37] The detriment caused in such a situation was evident in relation to the Swiss franc crash, where some investors unwittingly became liable for tens of thousands of euros, sums they were unable to pay. See ESMA CFD Measure, recital 122

Risk warnings

93. Another measure to address risks to retail clients in relation to CFDs is to require the provision of standardised and effective firm specific risk warnings including information on the percentage of retail client accounts' losses. As previously noted, several NCAs have noted the low quality of risk warnings provided to clients and have reported on CFD providers often failing to clearly set out the high-risk and complex nature of the products. In particular, risk warnings often do not clearly explain the potential for rapid losses that could exceed the money invested by clients, or the messages are diluted by the way warnings are presented or by statements about potential profits.

94. The firm specific risk warnings introduced in the Central Bank CFD Measure would provide retail clients with essential information about these particular products, namely the percentage of retail accounts losing money when trading CFDs.

95. A requirement for CFD providers to state the percentage of retail client accounts that are at a loss is designed to offset the tendency of CFD providers to highlight the potential profits over losses.

96. Furthermore, the warnings are expected to support retail clients in making an informed decision about whether they wish to proceed with a high risk product that is more likely to result in a loss than a gain.

97. In order to warn investors of the risk of losses related to investing in CFDs, the Central Bank considers that each CFD provider should inform their clients of the percentage of its CFD trading accounts of retail clients that lost money over the last 12 month period. To ensure the figure is kept up-to-date, this calculation should be updated on a quarterly basis. The percentage shown should be presented in a simple and clear manner as part of a risk warning in every communication of the provider.

98. In order to determine whether an account lost money, both the realised and unrealised profits or losses have to be taken into account. Realised profits and losses relate to the CFD positions that were closed during the calculation period. Unrealised profits and losses relate to the value of open positions at the end of the calculation period. In order to provide a complete picture of the percentage of accounts that resulted in a profit or loss all costs in

relation to the trading of CFDs should be taken into account in the calculation.

99. For newly established CFD providers and CFD providers that have not had any open CFD positions in the past 12 months, it is not possible to calculate such a percentage over the last 12 months. The Central Bank CFD Measure prescribes for these firms a standardised risk warning in which reference is made to the percentages found by NCAs in their existing studies, referred to in paragraph 38.

100. In order to ensure proportionality of this measure, the risk warnings have been adapted to the type of communication channels used. For this reason, an abbreviated risk warning and reduced character warning are prescribed in the Central Bank CFD Measure.

The prohibition of monetary and non-monetary benefits

101. A final measure to address risks relating to the distribution of CFDs to retail clients is a ban on monetary (for example so called 'trading bonuses') and certain types of non-monetary benefits. Financial promotions offering bonuses or other incentives to trade CFDs often distract retail clients from the high-risk nature of CFD products. They draw in retail clients who may not otherwise choose to invest in these products. Such benefits are often contingent on clients depositing money on the account or on executing a certain volume of trades.

102. The prohibition of benefits in the Central Bank CFD Measure however does not capture information and research tools provided to retail clients insofar as they relate to CFDs (excluded non-monetary benefits), as these would help clients' decision-making. Considering the risks posed to retail clients of these benefits, the Central Bank considers it is necessary and proportionate to restrict them.

Overall proportionality

103. The Central Bank, through its own supervisory work, and its engagement at ESMA, has reached the limit of the effectiveness of its non-binding tools in this area. The ESMA CFD Measure notes

that CFDs are commonly marketed, distributed or sold through online trading accounts.

104. The Central Bank's overall measure is necessary and proportionate to address the investor protection concern identified. In general, it is expected that it will reduce abnormal and significant losses experienced by retail clients on CFDs as well as enhance retail clients' awareness of the risks related to these products. The benefits gained from addressing the investor protection concern identified in the way proposed outweigh the potential consequences for CFD providers, including a potential (continued) reduction in CFD providers' revenues (through lower volumes of trading, lower total transaction fees paid by clients and lower client losses).

The measure does not have a discriminatory effect on services provided from another Member State

Article 42(2)(e) of MiFIR

105. The Central Bank considers that the national measure does not have a discriminatory effect on services or activities provided from another Member State as the measures provide for equal treatment of the marketing, distribution or sale of CFDs regardless of the Member State from which those services or activities are carried out.

Consultation and notification

Article 42(2)(d) and (f) of MiFIR

106. In accordance with Article 42(2)(d) of MiFIR, the Central Bank has properly consulted competent authorities in other Member States that may be significantly affected by the action.

107. In accordance with Article 42(2)(f) of MiFIR, the Central Bank has properly consulted the Department of Agriculture, Food and the Marine.

PART B

Central Bank of Ireland Contracts for Difference Intervention Measure

of 12 June 2019

pursuant to Article 42 of Regulation (EU) No 600/2014 of the European Parliament and of the Council of 15 May 2014 on markets in financial instruments and amending Regulation (EU) No 648/2012

(the Central Bank CFD Measure)

Pursuant to Article 42(1) of Regulation (EU) No 600/2014 of the European Parliament and of the Council of 15 May 2014 on markets in financial instruments and amending Regulation (EU) No 648/2012, and having regard to the criteria in Article 42(2), the Central Bank of Ireland hereby requires compliance with the below provisions.

1. Definitions

For the purposes of this measure:

(a) 'contract for difference' or 'CFD' means 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;

(b) 'excluded non-monetary benefit' means any non-monetary benefit other than, insofar as they relate to CFDs, information and research tools;

(c) 'initial margin' means any payment for the purpose of entering into a CFD, excluding commission, transaction fees and any other related costs;

(d) 'initial margin protection' means the initial margin determined by Annex I;

(e) 'margin close-out protection' means the closure of one or more of a retail client's open CFDs on terms most favourable to the client in accordance with Articles 24 and 27 of Directive 2014/65/EU when the sum of funds in the CFD trading account and the unrealised net profits of all open CFDs connected to that account falls to less than half of the total initial margin protection for all those open CFDs;

(f) 'negative balance protection' means the limit of a retail client's aggregate liability for all CFDs connected to a CFD trading account with a CFD provider to the funds in that CFD trading account.

2. Restriction on CFDs in respect of retail clients

The marketing, distribution or sale to retail clients of CFDs in or from Ireland is restricted to circumstances where at least all of the following conditions are met:

a. the CFD provider requires the retail client to pay the initial margin protection;
b. the CFD provider provides the retail client with the margin close-out protection;
c. the CFD provider provides the retail client with the negative balance protection;
d. the CFD provider does not directly or indirectly provide the retail client with a payment, monetary or excluded non-monetary benefit in relation to the marketing, distribution or sale of a CFD, other than the realised profits on any CFD provided; and
e. the CFD provider does not send directly or indirectly a communication to or publish information accessible by a retail client relating to the marketing, distribution or sale of a CFD unless it includes the appropriate risk warning specified by and complying with the conditions in Annex II.

3. Prohibition of participating in circumvention activities

It shall be prohibited to participate, knowingly and intentionally, in activities the object or effect of which is to circumvent the requirements in section 2, including by acting as a substitute for the CFD provider.

4. Date of application

This measure shall take effect from 1 August, 2019.

ANNEX I

INITIAL MARGIN PERCENTAGES BY TYPE OF UNDERLYING

(a) 3.33 % of the notional value of the CFD when the underlying currency pair is composed of any two of the following currencies: US dollar, Euro, Japanese yen, Pound sterling, Canadian dollar or Swiss franc;

(b) 5 % of the notional value of the CFD when the underlying index, currency pair or commodity is:

(i) any of the following equity indices: Financial Times Stock Exchange 100 (FTSE 100); Cotation Assistée en Continu 40 (CAC 40); Deutsche Bourse AG German Stock Index 30 (DAX30); Dow Jones Industrial Average (DJIA); Standard & Poors 500 (S&P 500); NASDAQ Composite Index (NASDAQ), NASDAQ 100 Index (NASDAQ 100); Nikkei Index (Nikkei 225); Standard & Poors / Australian Securities Exchange 200 (ASX 200); EURO STOXX 50 Index (EURO STOXX 50);

(ii) a currency pair composed of at least one currency that is not listed in point (a) above; or

(iii) gold;

(c) 10 % of the notional value of the CFD when the underlying commodity or equity index is a commodity or any equity index other than those listed in point (b) above;

(d) 50 % of the notional value of the CFD when the underlying is a cryptocurrency; or

(e) 20 % of the notional value of the CFD when the underlying is:

(i) a share; or

(ii) not otherwise listed in this Annex.

ANNEX II

RISK WARNINGS

SECTION A

Risk warning conditions

1. The risk warning shall be in a layout ensuring its prominence, in a font size at least equal to the predominant font size and in the same language as that used in the communication or published information.

2. If the communication or published information is in a durable medium or a webpage, the risk warning shall be in the format specified in Section B.

3. If the communication or published information is in a medium other than a durable medium or a webpage, the risk warning shall be in the format specified in Section C.

4. By way of derogation from paragraphs 2 and 3, if the number of characters contained in the risk warning in the format specified in Section B or C exceeds the character limit permitted in the standard terms of a third party marketing provider, the risk warning may instead be in the format specified in Section D.

5. If the risk warning in the format specified in Section D is used, the communication or published information shall also include a direct link to the webpage of the CFD provider containing the risk warning in the format specified in Section B.

6. The risk warning shall include an up-to-date provider-specific loss percentage based on a calculation of the percentage of CFD trading accounts provided to retail clients by the CFD provider that lost money. The calculation shall be performed every three months and cover the 12-month period preceding the date on which it is performed ('12-month calculation period'). For the purposes of the calculation:

   (a) an individual retail client CFD trading account shall be considered to have lost money if the sum of all realised and unrealised net profits on CFDs connected to the CFD trading account during the 12-month calculation period is negative;

   (b) any costs relating to the CFDs connected to the CFD trading account shall be included in the calculation, including all charges, fees and commissions;

   (c) the following items shall be excluded from the calculation:

      (i) any CFD trading account that did not have an open CFD connected to it within the calculation period;

(ii) any profits or losses from products other than CFDs connected to the CFD trading account;

(iii) any deposits or withdrawals of funds from the CFD trading account.

7. By way of derogation from paragraphs 2 to 6, if in the last 12-month calculation period a CFD provider has not provided an open CFD connected to a retail client CFD trading account, that CFD provider shall use the standard risk warning in the format specified in Sections E to G, as appropriate.

SECTION B

Durable medium and webpage provider-specific risk warning

CFDs are complex instruments and come with a high risk of losing money rapidly due to leverage. **[*insert percentage per provider*] % of retail investor accounts lose money when trading CFDs with this provider.** You should consider whether you understand how CFDs work and whether you can afford to take the high risk of losing your money.

SECTION C

Abbreviated provider-specific risk warning

[*insert percentage per provider*] % of retail investor accounts lose money when trading CFDs with this provider. You should consider whether you can afford to take the high risk of losing your money.

SECTION D

Reduced character provider-specific risk warning

***[insert percentage per provider]* % of retail CFD accounts lose money.**

SECTION E

Durable medium and webpage standard risk warning

CFDs are complex instruments and come with a high risk of losing money rapidly due to leverage. **Between 74-89 % of retail investor accounts lose money when trading CFDs.** You should consider whether you understand how CFDs work and whether you can afford to take the high risk of losing your money.

SECTION F

Abbreviated standard risk warning

Between 74-89 % of retail investor accounts lose money when trading CFDs. You should consider whether you can afford to take the high risk of losing your money.

SECTION G

Reduced character standard risk warning

74-89 % of retail CFD accounts lose money

Banc Ceannais na hÉireann
Central Bank of Ireland

Eurosystem