DILLON EUSTACE

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Central Bank uses its product intervention powers for first time to ban sales of binary options to retail investors and restrict the sale of CFDs

Background

On 12 June 2019, the Central Bank of Ireland announced measures to ban the sale of binary options to retail investors and restrict the sale of contracts for difference ("**CFDs**").

This marks the first time that the Central Bank has used its product intervention powers, introduced in 2018, which allow the Central Bank to restrict or prohibit the sale of certain types of products. The Central Bank had issued a warning to investors on CFDs and binary options in March 2018. These measures will take effect after the expiry of the European Securities and Markets Authority ("**ESMA**") temporary intervention measures which are currently in place.

Product Intervention Powers

The Central Bank's product intervention powers were introduced in Article 42 of the Markets in Financial Instruments Regulation ("**MiFIR**") (Regulation (EU) No 600/2014) which came into effect on 3 January 2018. These powers allow the Central Bank to prohibit or restrict the marketing, distribution or sale of a financial instrument, structured deposit or a type of financial activity or practice.

The Central Bank must be satisfied on reasonable grounds that the financial instrument, structured deposit, financial activity or practice gives rise to significant investor protection concerns, poses a threat to the orderly functioning and integrity of financial markets or has a detrimental effect on the price formation mechanism in the

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underlying market. The measure must be proportionate and not have a discriminatory effect on services or activities provided from another European Union Member State.

What is a Contract for Difference?

For the purposes of the intervention measure a CFD is 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.

What is a Binary Option?

For the purposes of the intervention measure a binary option is a derivative (whether traded on a trading venue or not) that meets the following conditions:

(i) it must be settled in cash or may be settled in cash at the option of one of the parties other than by reason of default or other termination event;

(ii) it only provides for payment at its close-out or expiry;

(iii) its payment is limited to:

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

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

Why are the measures being introduced?

The Central Bank has significant concerns from an investor protection perspective in relation to the sale of binary options and CFDs to retail clients. The factors the Central Bank note as giving rise to these concerns include their inherent complexity, the lack of transparency, the level of sophistication of investors, and evidence of investor losses. The Central Bank considers that a prohibition on the sale of binary options and the restriction on the sale of CFDs in respect of retail clients is necessary and proportionate to address their concerns about the risk to investors.

Central Bank's actions

The product intervention measures will prohibit the marketing, distribution or sale of binary options to retail investors. In respect of CFDs, the relevant measure will restrict the distribution, marketing or sale of CFDs in respect of retail investors. The restrictions will: (i) require that retail investors

cannot lose more money than they put into their CFD account; (ii) prohibit the use of incentives by a CFD provider; (iii) place limits on leverage; (iv) introduce a margin close requirement; and (v) impose a standardised risk warning.

When will the measures come into effect?

The European Securities Markets Authority ("**ESMA**") has imposed temporary product intervention measures in relation to binary options and CFDs since 2018. These ESMA measures have been issued on a rolling three months basis, with the current ESMA temporary measures due to expire on 2 July 2019 for binary options and 1 August 2019 for CFDs. The Central Bank's measures will enter into force on these dates.

Should you have any queries in relation to the issues raise in this bulletin, please contact the authors or your usual Dillon Eustace contact.

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