ESMA agrees to prohibit binary options and restrict CFDs to protect retail investors

Introduction

The European Securities and Markets Authority ("**ESMA"**) has agreed on measures on the provision of contracts for differences ("**CFDs**") and binary options to retail investors in the European Union ("**EU**").

The agreed measures include:

1. **Binary Options** - a prohibition on the marketing, distribution or sale of binary options to retail investors; and

2. **Contracts for Differences** - a restriction on the marketing, distribution or sale of CFDs to retail investors. This restriction consists of: leverage limits on opening positions; a margin close out rule on a per account basis; a negative balance protection on a per account basis; preventing the use of incentives by a CFD provider; and a firm specific risk warning delivered in a standardised way.

In accordance with Markets in Financial Instruments Regulation ("**MiFIR**"), ESMA can only introduce temporary intervention measures on a three monthly basis. Before the end of the three months, ESMA will consider the need to extend the intervention measures for a further three months.

Significant Investor Protection Concern

ESMA, along with National Competent Authorities ("**NCAs**"), concluded that there exists a significant investor protection concern

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in relation to CFDs and binary options offered to retail investors. This, in its view, is due to their complexity and lack of transparency; the particular features of CFDs – excessive leverage – and binary options - structural expected negative return and embedded conflict of interest between providers and their clients; the disparity between the expected return and the risk of loss; and issues related to their marketing and distribution.

CFDs – agreed measures

The product intervention measures ESMA has agreed under Article 40 of the MiFIR include:

1. Leverage limits on the opening of a position by a retail client from 30:1 to 2:1, which vary according to the volatility of the underlying:

    - 30:1 for major currency pairs;
    - 20:1 for non-major currency pairs, gold and major indices;
    - 10:1 for commodities other than gold and non-major equity indices;
    - 5:1 for individual equities and other reference values;
    - 2:1 for cryptocurrencies;

2. A margin close out rule on a per account basis. This will standardise the percentage of margin (at 50% of minimum required margin) at which providers are required to close out one or more retail client's open CFDs;

3. Negative balance protection on a per account basis. This will provide an overall guaranteed limit on retail client losses;

4. A restriction on the incentives offered to trade CFDs; and

5. A standardised risk warning, including the percentage of losses on a CFD provider's retail investor accounts.

ESMA intends to adopt these measures in the official languages of the EU in the coming weeks, following which ESMA will publish an official notice on its website. The measures will then be published in the Official Journal of the EU (OJ) and will start to apply one month, for binary options, and two months, for CFDs, after their publication in the OJ.

Should you require any information please do not hesitate to contact your usual contact at Dillon Eustace.

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