

CALL FOR EVIDENCE OF ESMA Potential product intervention measures on CFD and binary options to retail clients

AMAFI comments

Association française des marchés financiers (AMAFI) is the trade organisation working at national, European and international levels to represent financial market participants in France. It mainly acts on behalf of credit institutions, investment firms and trading and post-trade infrastructures, regardless of where they operate or where their clients or counterparties are located. AMAFI has more than 130 members operating for their own account or for clients in equities, fixed-income products and derivatives. Nearly one-third of its members are subsidiaries or branches of non-French institutions.

AMAFI welcomes the opportunity to comment on ESMA's call for evidence on potential product intervention measures on contracts for differences and binary options to retail clients. Considering that AMAFI is a professional association and, as such, does not market financial products, it is not able to answer questions B to H but only to question A. Nevertheless, before answering question A, AMAFI would like to make more general remarks, notably on the fact that the risks incurred by retail clients on speculative products is indeed a very serious issue that needs to be addressed. We then provide remarks in the context of those proposals that constitute the first implementation of product intervention power by ESMA.

For the avoidance of any doubt, AMAFI wishes to stress out that it fully supports the objective to protect the less sophisticated clients from presumably not fully compliant with EU rules professionals that market and or sell such highly risky and speculative products to them. When many retail investors suffer from great losses, it harms confidence and trust in all investments in financial markets. It is detrimental at a time when markets have to play a greater role in financing the economy, especially for markets participants like AMAFI members. Therefore, AMAFI do support the idea of product intervention in this particular context.

GENERAL REMARKS

Above all, AMAFI is indeed fully aware that there is a real and serious issue in marketing these highly risky products to inexperienced retail investors and approves the idea to set up an effective solution at European level. However, it is necessary to do it in the most effective way. Thus, it seems essential to take the necessary time to analyze precisely the current situation and address the right answer.

As a matter of fact, we believe that ESMA should investigate whether the issues at stake had to be attributed to inefficient or lack of supervisory and enforcement missions carried out by some national authorities rather than to an inadequate regulatory environment. To this end it should be interesting for ESMA to investigate the supervisory procedures implemented by national competent authorities on the cross-border activities carried out by investment firms established in their respective territories.

Another point which is not addressed by ESMA's proposal is that this typology of products is largely issued to retail investors by non-financial entities (in particular by the diffusion of banners on their websites) or non-EU entities. Then, we do not see how the ban set up by ESMA could change this situation. Indeed, it seems to us that the CFDs and Binary Options market is by far dominated by non-EU trading platforms which illegally offer their services to EU citizens on a cross-border basis, in the absence of any authorisation and supervision whatsoever. In that perspective, actions taken in France, notably by providing request power to the AMF against entities that provide investment services online without authorization and fines for advertising or marketing intermediaries that would not comply with marketing restrictions, is worth mentioning.

Finally, while it is the first time that ESMA uses its product intervention powers allowed by article 40 of MiFIR, AMAFI would like to point out some disconcerting elements in the implementation of this process which has structuring impacts on the financial markets.

COMMENTS ON DECISION-MAKING PROCESS AND THE FORM OF THE MEASURES PROPOSED BY ESMA

First of all, although a press release was published in mid-December but did not detail the measures envisaged by ESMA, available only since the 18th of January, AMAFI is very surprised by the short response time (less than three weeks) given to respondents for such a structuring process. It seems absolutely necessary to take the time to think about the specific prohibition conditions in order to avoid that they have side effects on financial instruments or customers that should not be targeted.

For similar reasons, it would seem relevant and important that a consultation on the final drafting of "product interventions" be conducted by ESMA before their final publication. Indeed, a decision as important and structuring as intervention powers – generally speaking – should be determined after a deep and wide collaboration with all NCAs, the industry and consumers. We doubt that the call for evidence format, and with such short notice, allows the better collaboration. This is troubling especially since it is the first time that ESMA is using its new intervention powers. We think that the process followed today can determine, for the future, the general process for all next intervention measures and somehow "set a precedent". Therefore, it seems important to AMAFI that governance of those first intervention measures is satisfying.

Moreover, it would seem relevant to include in this document the evidence that, when implementing this intervention process, ESMA fulfils the legal framework laid down in article 40 of MiFIR and that the three cumulative conditions are thus met:

"(a) 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;
(b) regulatory requirements under Union law that are applicable to the relevant financial instrument or activity do not address the threat;
(c) 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."

Regarding point (a), the justifications provided by ESMA do not seem sufficiently precise: "several NCAs have also conducted analyses or studies showing that between 74 and 89% of clients trading in these products lose money". While clearly striking, it seems important to specify the sources of these studies as well as the type of investors and financial instruments specifically studied, the dates on which those were made and the periods of collected data. Above all, as already mentioned, it is necessary to be precise about the percentage of customers who, being solicited from outside the EU and so will not benefit from the restrictive measures proposed by ESMA. In the end, it is the contribution of the ban "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" which is at stake.

Regarding point (b), MiFID 2 investor protection rules are already supposed to avoid, or at least restrict, cases of wrong marketing and misselling. Indeed, by establishing a positive target market, and where necessary, such as for products as complex and risky as CFDs and binary options, a negative target market (recalling five criteria including experience and knowledge, the ability to bear losses and risk tolerance), it would appear that the risk of investment firms marketing such products to retail clients with too little experience and knowledge and / or low capacity to bear losses and / or a limited risk tolerance is already captured.

It would be interesting for ESMA, concerning the persons subject to EU regulations, to explain why MiFID 2 rules including appropriateness and suitability requirements as well as product governance ones are insufficient and how this intervention measure fit within those.

Regarding point (c), for the subject dealt here, as mentioned by ESMA in its document, corrective measures have been set up in various European countries, for example in France : *“several NCAs have also taken actions to address risks to investor protection arising from these products”*. AMAFI believes that these actions should be further analysed by ESMA, especially with respect to the obligation to show that either some NCAs “have not taken action to address the threat” or that “actions that have been taken do not adequately address that threat”. Does the European Authority consider that the national actions taken so far are irrelevant or inefficient? Or, to the opposite, is the aim to expand such actions to the EU as a whole? In any case, how will the European intervention - which is temporary by nature - fit with national ones? Furthermore, we did not well understand this temporary aspect of the measures proposed by ESMA: for how long will it be enforced? What is planned for the review process?

So legal questions could be raised as well: how those measures could have effect on existing agreements concluded with clients? Should those measures only apply to future agreements or as well to existing ones? In the latest, should the contract be considered as void?

Moreover, it is up to ESMA to specify how a temporary measure by nature can respond in the long term to the objectives it pursues. It is not possible for a temporary measure to be extended indefinitely.

Given the sensitive consequences of these restrictions, it seems essential that there are no elements of ambiguity about their validity in order to avoid any legal uncertainty for all stakeholders.

In light of the remarks above, AMAFI urges ESMA to detail further the envisaged measures and providing answers to the questions we raised in a form of a Consultation Paper with a three months delay for all stakeholders to provide thoughtful input and contribution.

ANSWER TO QUESTION A

Question A: Do you think that ESMA has adequately identified the instruments in the scope of its possible measures (paragraphs 3 and 5 above)?

Once again, AMAFI does not question the reality of the issue and the need to resolve it - or at least reduce it - as efficiently as possible. Nevertheless, it is important to ensure that the drafting of the measure does not come into question other types of products which would have similar characteristics but additional measures to better protect the investor (such as capital guarantees at maturity or the assurance of not losing more than the invested capital) or target investors who should not be.

In that context, AMAFI would like to be sure that the definition of the targeted products: binary options and CFDs are sufficiently precise and well designed to avoid any risk to capture, directly or indirectly any other financial instruments. Without a genuine consultation process, we are not in the capacity to confirm or challenge this assumption.

But it would certainly help if **ESMA would add in the future text that those definitions indeed specifically exclude any other financial instruments such as securities, structured securities (on the latest, AMAFI share the concerns expressed by AFPBD in its answer to the call for evidence), investment funds and all derivatives financial instruments that are not binary options.**

Furthermore, some of the measures proposed by ESMA do lack of precisions. When defining CFDs restrictions with leverage limits, AMAFI notes that many categories are determined vaguely (the use of footnote for instance is a bit confusing), openly and without any explanation for making those different categories. Again, for consequences as serious as intervention measures, those should not suffer from any ambiguity.

The proposal of standardised risk warning raises some questions as well. AMAFI supports the idea of a risk warning but to oblige to rely on studies and analysis conducted by third parties or to calculate those statistics from their own data might be difficult to implement or at least with sufficient legal security. We would very much favour a standardised narrative, based on the example of comprehensive alert inspired from PRIIPs added in the marketing communication of the product –, such as *“be aware that this product is very risky and that you can lose a lot of money”*, much simpler to implement and should have the same effect on investors.

AMAFI wishes to share some concerns it has about the margin close-out rule as proposed by ESMA on a position-by-position basis, which is set at 50% of the amount of the initial margin posted. First, we cannot confirm at this stage that the measure do not create negative effects for the client. Second, one can wonder if that means that we should conclude that in the near future retail investors' positions will have to be closed once the value of the financial instrument has decreased by 50%? Could that mean that retail clients no longer have the right to invest in risky products - particularly when they want to diversify their portfolios - even as measures to increase their protection have been set up through the strengthen of investor protection rules in MiFID 2 (Product Governance and suitability notably) and PRIIPs? If we consider that retail clients are still allowed to invest in risky but sometimes as well performing investment, this is a question worth mentioning and we rather not set a “precedent” that will have such side effects.

Finally, AMAFI wishes to point out that Governance Products requirements have taken into consideration the fact that under the terminology "retail investors" there is a great granularity in this range of category of investors: those not informed (“basic investors”) or wanting to take very little capital risk on the one hand and those very sophisticated (“advanced investors”), able of bear losses and wanting diversified and performing portfolios on the other hand. However, the measures developed here place all retail investors on the same level without making any distinction, for example with regard to the leverage limits. It is disappointing that ESMA do not make reference to that level of granularity set up for Governance products for its intervention measures considering it was a great deal of work to implement from professional's point of view and a real progress in terms of selling practices and investors protection as a whole.

