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The Spanish National Securities Market Commission Resolution of 27 June 2019, on product intervention measures for binary options and financial contracts for differences.

Official State Gazette number 155, of 29 June 2019

Binary options (hereinafter, BOs) and financial contracts for differences (hereinafter, CFDs) are particularly complex financial instruments, which are mainly characterised by their complexity and high risk, and their high volatility in the short term. In the case of CFDs, they are also leveraged instruments where investors may incur losses exceeding the amount initially paid.

CFDs and BOs are products that are usually offered to retail investors through electronic trading venues, without the provision of investment advice or portfolio management services. The suitability assessment required under prevailing legislation enables the client to make the investment, upon issuance of the relevant warnings, even when sufficient information related to the client's knowledge and experience has not been provided, as well as when the intermediary has concluded that the product is not suitable for the investor.

The features and risks of these products are difficult to understand. Therefore, they are not suitable for most retail clients, and accordingly, they must not be marketed, in general, among these clients. Frequently, the prices, costs and trading terms and conditions of CFDs and BOs are not sufficiently transparent, thus not enabling retail investors to properly understand the product terms or assess their expected return or the risks assumed.

When marketing these products, intermediaries normally focus on positive aspects, and place less emphasis on information related to the risks and their complexity. Misleading marketing campaigns, aggressive marketing strategies and inappropriate practices (commercial benefits to attract and encourage investments in these products, gifts, low fees, etc.) have been detected, which divert the attention from the high risk of the products. In addition, promoting these products, through sponsorship agreements with very popular sports teams and distributing misleading commercial messages in the media or through websites, is aimed at raising awareness of and generating a demand for these products among retail clients, when in view of their complexity and risk these clients are not their target public.

BOs enable investors to bet on the short-term fluctuation of the prices of one or more underlying assets, expressed in terms of two predefined scenarios, and therefore, do not respond to any real investment requirements of investors. In general, BOs have a very short-term maturity and are traded for purely speculative purposes. They are financial instruments whose features are typically associated with gambling rather than with financial investments, and hence, BOs may promote addictive behaviours among investors.

Leverage is the most important factor contributing to many retail clients not being aware of the high risks to which they are exposed when investing in CFDs. This is because there is a higher probability of the investor not having sufficient margins to hold their open positions in the event of fluctuations in the prices of the underlying assets, and the investor's positions are often closed automatically, leading to losses that exceed the amount paid by the clients as margin.

Similarly, leverage also makes it harder for investors to understand the impact that fees and spreads paid have on the expected return, as these are based on the notional amount of the transaction and not on the margins posted by the client.

In view of this scenario, a large number of national competent authorities, including the CNMV, have been expressing their concern about the increase in the distribution of CFDs and BOs to the retail client segment, despite being products that are complex and unsuitable for most of them. Both ESMA and the CNMV have issued various warnings to investors highlighting the risks and the high probability of clients incurring losses when investing in these financial instruments. In the case of the CNMV, various measures have also been adopted to address these concerns.

In parallel to the carrying out of these initiatives, the CNMV has become part, together with other national competent authorities, of a work group created by ESMA in 2015 to supervise the marketing of these products and to promote homogeneous supervisory approaches across the European Union. Upon completion of in-depth analyses on the marketing of CFDs and BOs, which have been carried out since the creation of the work group, both ESMA and the national authorities concluded that there are still real concerns about investor protection with regard to the marketing of these financial instruments to retail clients. Specifically, ESMA gathered information on specific studies conducted by different national competent authorities, including the CNMV, on the return obtained by retail clients who invested in CFDs, which showed that between 74% and 89% of investors lose money when they trade with CFDs.

On 3 January 2018, with the entry into force of Regulation (EU) 600/2014 of the European Parliament and of the Council, of 15 May, on markets in financial instruments, the powers of ESMA and of the competent authorities were extended through an explicit mechanism which permits, subject to the fulfilment of certain specific conditions, to forbid or establish restrictions on the marketing, distribution and sale of any financial instrument which creates a significant investor protection concern.

Using this new power, and in order to address the concerns regarding the marketing of CFDs and BOs to retail clients, on 22 May 2018 ESMA decided to forbid the marketing, distribution and sale of BOs to retail investors throughout the European Union, from 2 July 2018, and to restrict the marketing, distribution and sale of CFDs to retail investors within the European Union, from 1 August 2018. These decisions, adopted pursuant to Article 40 of Regulation (EU) 600/2014, prevail over any other measure previously implemented by the competent authorities, were applicable on a temporary basis for a period of three months from their entry into force. ESMA has renewed these measures three times as it considers that there are still significant investor protection concerns.

In light of the foregoing, the CNMV also considers that there are still real concerns about investor protection with regard to CFDs and BOs offered to retail clients. The CNMV fully supports the Decisions adopted by ESMA and considers that product intervention powers are the best tool to address these concerns and to ensure that retail investors throughout the European Union have a common level of protection.

In order to give stability to the decisions adopted by ESMA, the CNMV considers that it would be advisable to adopt a resolution that enables implementing these measures in Spain with no definite time limit, subject to review in the event of a change to market circumstances, which clarifies their application within the context of our regulatory framework, and in particular, their interaction with CNMV Circular 1/2018, of 12 March, on warnings regarding financial instruments.

The measures proposed by the CNMV to address these concerns coincide with those adopted by ESMA, and hence, comply with the requirements under Article 42 of Regulation (EU) 600/2014 for their adoption, including the assessment of the criteria and factors stipulated in Article 21 of Delegated Regulation (EU) 567/2017, such as the existence of a significant investor protection concern, the non-existence of other alternatives under law to sufficiently address the issue, the proportionality of the measure and its non-discriminatory effect. The CNMV has considered all the arguments put forward in ESMA's Decisions, as well as the supervisory experience of other national competent authorities also referred to in these Decisions.

With regard to the consultation made to other competent public bodies on the supervision, management and regulation of the actual agricultural markets under Regulation (EC) 1234/2007, according to Article 42(2)(f) of the Regulation, as ESMA made such consultation and there were no objections or comments from the Spanish competent public bodies, the CNMV has considered that a new consultation in this regard is not required, concluding that there is no serious threat to the orderly functioning and integrity of the actual agricultural markets.

Prior to implementing the measures contained in this resolution, the CNMV has complied with the obligation of reporting them to ESMA and the remaining competent authorities for their knowledge, at least one month before their entry into force.

These measures shall be applicable to the entire activity of marketing, distributing and selling these products to retail clients residing in Spanish territory, irrespective of the origin of the firm that markets and distributes these products, or the existence or otherwise of a branch in Spain. Additionally, the measures shall be applicable to the Spanish firms that market, distribute or sell these products in other EU Member States. If these firms are subject to this Resolution and to intervention measures applied by another Member State that differ from those contained in this Resolution, the strictest ones shall be applicable.

This Resolution, as is also stipulated in ESMA's Decision, considers that CFDs include, *inter alia*, rolling spot forex contracts and financial spread betting, whether or not they are traded on the market. Similarly, warrants and turbos are not included within the scope, but securitised derivatives which are CFDs are not expressly excluded.

With regard to the interaction of the measures under this Resolution with CNMV Circular 1/2018, the requirement to obtain the retail client's written statement or recording shall be maintained, at least for the first two opening position transactions, in accordance with the aforementioned Circular, which shall be added to a new text for the warning referred to in this Resolution, which replaces the text laid down in the Circular for CFDs. By means of this Resolution, this requirement to obtain the client's written statement or recording shall be extended to firms that market these products under the freedom to provide services in Spain.

Finally, the CNMV considers that it would be a good practice for firms to define a policy to determine the appropriate additional margins, such that investors could be informed before the initial margin threshold of 50% is reached, which implies the obligation of closing the position, thus enabling them to post additional margins, or where appropriate, to close the position, before this threshold is reached.

Pursuant to Article 234(2)(p) of the Securities Market Act, the CNMV's Board, using the powers that correspond to the CNMV on the intervention of products and practices or financial activities laid down in Articles 40 to 42 of Regulation (EU) 600/2014, of the European Parliament and of the Council, of 15 May, at its meeting held on 27 June 2019, has adopted, prior to public consultation and report from the Advisory Committee, the following resolution:

CHAPTER I

Binary Options

Article 1. Prohibition on binary options in respect of retail clients

1. The marketing, distribution or sale to retail clients of binary options is prohibited.

2. For the purposes of paragraph 1, irrespective of whether it is traded on a trading venue, a binary option is a derivative that meets the following conditions:

   (a) 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;

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

   (c) its payment is limited to:

   i) a predetermined fixed amount or zero if the underlying of the derivative meets one or more predetermined conditions; and
   ii) a predetermined fixed amount or zero if the underlying of the derivative does not meet one or more predetermined conditions.

3. The prohibition in paragraph 1 does not apply to:

(a) a binary option for which the lower of the two predetermined fixed amounts is at least equal to the total payment made by a retail client for the binary option, including any commission, transaction fees and other related costs;

(b) a binary option that meets the following conditions:

i) the term from issuance to maturity is at least 90 calendar days;
ii) a prospectus drawn up and approved in accordance with Directive 2003/71/EC of the European Parliament and of the Council is available to the public; and
iii) the binary option does not expose the provider to market risk throughout the term of the binary option and the provider or any of its group entities do not make a profit or loss from the binary option, other than previously disclosed commission, transaction fees or other related charges.

Article 2. 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 Article 1, including by acting as a substitute for the binary option provider.

CHAPTER II

Contracts for differences

Article 3. Definitions

For the purposes of this Resolution:

(a) «contract for differences» 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.

Article 4. Restriction on CFDs in respect of retail clients

The marketing, distribution or sale to retail clients of CFDs 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.

Article 5. 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 Article 2, including by acting as a substitute for the CFD provider.

CHAPTER III

Entry into force of the measures

Article 6. Entry into force and application

This Resolution shall enter into force, once it is published in the Spanish Official State Gazette (BOE), on the day following that on which ESMA's measures on binary options and contracts for differences, respectively, cease to have effect. Therefore, Chapter I of this Resolution, related to binary options, shall take effect on 2 July 2019 and Chapter II, related to contracts for differences, shall take effect on 1 August 2019.

In order to give continuity in Spain to the Decisions adopted by ESMA on binary options and CFDs, the measures included in this Resolution shall apply as long as the CNMV does not observe any changes in market circumstances that allow the derogation of the measures.

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ANNEX I

CFD 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

CFD 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 to 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.