



**ESMA Call for evidence**  
**Effects of product intervention measures**  
**regarding CFDs and binary**  
**options on market participants and clients**

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**Comments of the French AFPDB**  
**(French Retail Structured Product**  
**Association)**

On the occasion of the ESMA Call for evidence on the effects of product intervention measures regarding CFDs and binary options on market participants and clients, the AFPDB<sup>1</sup>, the French association of retail structured product manufacturers, would like to share its views with ESMA on its experience with the adopted measures and on the possible improvements that could be brought to the existing regulatory framework.

**About the AFPDB and its members**

The French AFPDB represents the leading retail structured product issuers that are active on the French marketplace. Their product offering includes both securitized derivatives such as warrants, certificates and turbos and structured notes (e.g. EMTNs) whether distributed through public offerings or private placements.

The AFPDB membership includes both French and other European credit institutions. Together, its members account for over 95% of the exchange-traded securitized derivatives that are traded in France, both in terms of traded volumes or number of trades. These products may be used by retail investors in a variety of strategies (replication, hedging, leverage...) on a variety of underlying assets (equities, indices, commodities, forex...).

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<sup>1</sup> AFPDB : Association Française des Produits d'investissement de Détail et de Bourse

## Answers to questions A to G

**A: In addition to the effects of ESMA's product intervention measures regarding CFDs mentioned in the renewal Decisions and in paragraphs 22-24 above, were there further practical effects of ESMA's product intervention measures regarding CFDs on you as a market participant that you would like to share?**

See answer to question E.

**B: In addition to the effects of ESMA's product intervention measures regarding binary options mentioned in the renewal Decisions and in paragraphs 21, 23-24 above, were there further practical effects of ESMA's product intervention measures regarding binary options on you as a market participant that you would like to share?**

### 1. Issue with the scope of the measure

In its Q&A dated 30 March 2017 relating to the provision of CFDs and other speculative products to retail investors under MiFID, ESMA reported about the abusive practices that accompanied the distribution of CFDs, binary options and rolling spot forex. In this Q&A, ESMA also rightly observed that these speculative bilateral contracts "are typically sold on an over-the-counter (OTC) basis and not through a regulated market or multilateral trading facility (MTF)".

However, despite the clear OTC nature of the identified abusive practices, ESMA chose to extend the measure to products that were listed on regulated markets or on MTFs. This extension was not backed with supporting evidence concerning listed products.

For reference, for binary options, in its January 2018 call for evidence, the ESMA continued to refer to these options as "derivatives". It was only in the publication of "additional information on the agreed product intervention measures related to CFDs and binary options" issued in March 2018 that the ESMA explicitly mentioned that securitized derivatives would also be included without any explanation on the rationale of this extension.

This extension affected listed products issued with different characteristics. For that reason, in their replies to the initial ESMA consultation, the AFPDB and its sister European associations recalled that listed products offer a full range of investor protections.

For reference, these protections, among others, have the following features;

- A capital risk that is capped to the limited invested amount (non-recourse products);
- A regulated product issuance framework; involving:
- A fair, liquid and transparent secondary market;
- A fair business model thanks to hedged positions, limiting conflicts of interests;
- Established industry codes of conduct;

### 2. Spill-over effect: Issues related to the ambiguous definition

As the definition provided by ESMA of binary options was relatively ambiguous, manufacturers and distributors received questions in several jurisdictions about some long-term structured notes despite the fact that their payoff that was very clearly outside of the intended scope of the measure.

In France, these concerns were usefully addressed by the French AMF. The French financial markets authority organized several consultations with industry participants to ensure that the measure scope would be well understood. These communication efforts helped mitigate the risk of a spill-over effect that would have resulted from a misunderstanding of the measure potentially leading to the practical exclusion by market participants of a much wider scope of products than those actually targeted.

For the future, the AFPDB would urge the ESMA to carefully assess such unintended spill-over risks. When possible, it would be useful to provide examples of products that are explicitly outside of the scope of the measure.

**C: As a market participant, did you experience any issues arising from the transition between ESMA's and national product intervention measures or from differences between the national product intervention measures taken by NCAs in different jurisdictions?**

The national product intervention measures that were adopted by the French AMF on the 2<sup>nd</sup> of July 2019 were directly in line with the ESMA measures (i.e. identical provisions and product scope).

For the AFPDB, this continuity in the transition between the ESMA's and national product intervention measures is of high importance as it ensures both stability and consistence in the measure implementation in the various EU jurisdictions.

The AFPDB also considers that the proportionality test that is set-out in Article 42.2 c) of MIFIR should apply in equal terms to both ESMA's and NCAs' measures. This provision submits product intervention measures to a prior assessment of the proportionality of the expected effects of the intended measures on investors and market participants with the identified risks.

The ESMA intervention power is currently meant to be a temporary measure. When needed, longer-term measures are supposed to be taken at a national level.

With the successive renewals of CFD and binary options measures by the ESMA, the temporary nature of the ESMA intervention power was undermined.

While AFPDB members acknowledge that the national transposition process may take time, they are concerned by the precedent of an intervention measure that may be "automatically" renewed. Such precedent introduces the risk that the rationale for maintaining such impacting measures shall be insufficiently reviewed.

In their opinion, prior to renewing a measure it is crucial to ensure that its rationale has been duly reviewed and that the corresponding research and evidence (e.g. market data) have also been updated accordingly.

**D: As a client, do you experience any issues arising from the transition between ESMA's and national product intervention measures or from differences between the product intervention measures taken by NCAs in different jurisdictions?**

Not applicable to AFPDB members.

**E: What is your view on the temporary nature (see paragraph 4) of ESMA's product intervention powers?**

(Please see also our answer to question C.)

AFPDB members are aware that some stakeholders support the possibility of an extension of the duration of the ESMA intervention measures.

For the AFPDB, if such extension were decided it would be crucial to ensure that the long term ESMA intervention measures be reviewed at least annually.

This yearly revision requirement should also apply to NCA's decisions, including those adopted prior to MIFIR, especially when modified or updated afterwards.

For the latter requirement, the AFPDB is aware that it would imply a level-one review of MIFIR.

**F: Would you have any examples of circumvention of the product intervention measures? If yes, could you please share your views on such circumvention.**

The AFPDB sees two types of circumvention, whether they relate to industry practices (1 to 3) or the NCAs (4 and 5).

1. Unregulated or poorly regulated activities

In the case of binary options, AFPDB notes that most of the reported abuses were related to unregulated entities. For many of them the product or service offering was essentially a way to entice customers into online financial scams. In other instances, smaller intermediaries engaged in large-scale mis-selling of OTC derivative contracts to uninformed retail investors. Due to intentionally poor information on product features or unfair practices, these investors did generally not appreciate the involved risks. The consequences of this misinformation or other abuses were especially severe when products involved a non-limited recourse exposing investors to losses greatly exceeding their initial investment.

The AFPDB, together with its sister associations within EUSIPA, the leading European structured product association, had raised the alarm for years against these abusive practices.

As these players and practices prospered outside of the regulatory framework or in poorly regulated environments, there is consequently little improvement to be expected from a regulated product intervention.

2. Product repackage

This situation would theoretically concern manufacturers that would repackage their products into another legal vehicle (wrapper).

However, despite this possibility to repackage with another legal wrapper, AFPDB members are of the view that this should not in itself constitute a sufficient rationale for restricting products already manufactured with this latter wrapper and that do not present the same risks as the ones originally identified as problematic. This is especially true, when existing products benefits from specific proven and established investor protection features (such for examples as those existing for listed products, as recalled in our answer 1) to question B.

3. Client recategorisation

AFPDB has observed that some distributors have engaged in the highly questionable practice of actively promoting with their retail clients the possibility of an opting-up for the professional category so as to offer them CFDs or binary options without being impacted by the applicable product intervention measures that only affect the solicitation and sale to retail clients. Such practice is in our view probably non-compliant with current MIF 2 regime that sets out sufficient conditions for such opt in/up and therefore calls out for appropriate supervision by NCAs rather than changes of the rules.

4. “Soft-law” product bans

In several jurisdictions, NCAs have already applied national sale or solicitation restrictions that are de-facto intervention measures though they were not identified as such and were consequently not submitted to the same due process. These measures were generally adopted before MIFIR and were therefore not submitted to the ESMA reporting requirement at the time of their implementation. However, after the adoption of MIFIR, several of these measures have been subject to modifications that should have been reported but were generally not.

5. “Voluntary self-regulation” industry measures...adopted on NCA invitation

The AFPDB is aware that in some jurisdiction, NCAs have “invited” the industry to “voluntarily” adopt a restrictive product governance set-up whereby it must limit its product manufacturing or distribution to retail clients.

The AFPDB disapproves the questionable practices mentioned in the above cases 4) and 5) of NCAs avoiding the due reporting and consultative process that would be applicable to such de-facto intervention measures.

Moreover, in such cases the AFPDB regrets the very binary nature of the adopted measures that tend to apply restrictions to all retail clients instead of applying the more granular approach that should normally prevail under the newly established MIFID2 Product Governance (PG) framework.

For the AFPDB, it would be very desirable to use the same granularity in the definition of scope of investors concerned by intervention measures as for PG criteria applying to target markets. Indeed, for measures applying to retail investors, it would make sense to consider the experience and financial situation of the said investors, as manufacturers and distributors are required to do in their own internal PG exercises. This would make even more sense with the very significant efforts that

the financial industry has made in the area of harmonization and templating of target market information (such as through the not-for-profit Findatex initiative of standardized European MIFID2 templates -EMTs).

**G: Are there any suggestions or comments you wish to share to improve the application of the regulatory framework regarding the product intervention powers?**

The AFPDB would recommend the following improvements in the regulatory framework that applies to product interventions:

1. Vigilance on commercial practices and conflicts of interests: many abusive practices developed by unscrupulous unregulated or poorly regulated players have little to do with the actual product payoff or wrapper. For them the product or service offering was essentially a way to entice customers into online financial scams or to sustain business models that are intrinsically conflicted;
2. Scope: Enhanced vigilance concerning the consistence between the initial assessment and the final product scope of the intervention measure;
3. Spill-over: Enhanced clarity in the definition of covered products (with clear mention of out-of-scope products when confusion risks are present);
4. ESMA review of pre-MiFIR measures whose modifications should fall under the ESMA product intervention framework;
5. ESMA oversight of soft-law and other “voluntary self-regulation” national intervention measures initiated by NCAs;
6. Enhanced granularity in the target market exclusion of future product interventions (avoiding all or nothing approaches concerning retail exclusions, with appropriate reference to experience and financial situation).

