FINANCIAL CONDUCT AUTHORITY

Restricting contract for difference products sold to retail clients

Policy Statement
PS19/18

July 2019

This relates to

Consultation Paper 18/38
which is available on our website at
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1 Summary

1.1 In December 2018, we published Consultation Paper (CP)18/38 – 'Restricting contract for difference products sold to retail clients and a discussion of other retail derivative products'. In this CP, we consulted on measures restricting how contracts for difference (CFDs)[1] and CFD-like options[2] could be sold to retail consumers.[3]

1.2 These measures sought to address poor conduct by UK and EEA firms offering CFDs to retail consumers, and reduce consumer harm by limiting the sale of CFDs and other directly substitutable products with excessive risk features.

1.3 This Policy Statement (PS) summarises the consultation feedback that we received. We also outline our final policy and Handbook rules that will come into force on 1 August 2019 for CFDs, and 1 September 2019 for CFD-like options.

1.4 We also summarise the feedback to our discussion on policy considerations for futures and other leveraged derivatives products in CP18/38. Having considered the feedback, we are not proposing to extend the scope of our intervention measures. We will re-consider extending the scope of our rules if we see evidence of harm.

1.5 We will shortly publish a CP on a potential ban on the sale to retail clients of derivatives and certain transferable securities that reference cryptoassets, following our public commitment in the UK Cryptoasset Taskforce Final Report. Should we decide to proceed with a ban following that consultation, such rules would replace our final measures restricting how CFDs referencing cryptocurrencies are sold to retail clients.

Who this affects

1.6 Our proposals will directly affect:

- retail clients or potential retail clients who invest in CFDs and CFD-like options
- MiFID investment firms, including Capital Requirements Directive (CRD) credit institutions as appropriate, who are marketing, distributing or selling CFDs and CFD-like options in, or from, the UK to retail clients
- UK branches of third-country investment firms who are marketing, distributing or selling CFDs and CFD-like options to retail clients

1 References to CFDs in this PS include references to CFDs, spread bets, and rolling spot forex contracts that qualify as MiFID financial instruments.

2 Under our rules, CFD-like options are defined as "an option (1) that is in the money at the point of sale, (2) where the value is determined by one-to-one fluctuations in the value or price of the underlying asset, and (3) for which the value is not significantly affected by the time to expiry.

3 References to retail consumers refers to consumers treated as retail clients according to COBS 3.4.

The wider context of this policy statement

Our consultation

1.7 CP18/38 proposed a package of policy measures restricting how CFDs and CFD-like options could be marketed, distributed, and sold to consumers treated as retail clients. Our proposed intervention followed supervisory evidence of significant harm to retail consumers caused by excessive levels of leverage on CFDs, and poor conduct by some firms offering CFDs and CFD-like options to retail consumers.

1.8 We proposed these measures following the European Securities and Markets Authority's (ESMA) application of temporary product intervention measures. This was in response to EU-wide evidence of harm to retail consumers and poor conduct by firms. ESMA's measures have successfully reduced consumer harm by lowering the number of active retail clients trading CFDs and reducing the total losses experienced by retail consumers.

1.9 We proposed making ESMA's temporary intervention measures permanent. However, our proposals had some differences from ESMA's temporary intervention in that they:

- apply to a wider range of products by including CFD-like options
- limit leverage for CFDs referencing certain government bonds to 30:1 (compared with 5:1 under ESMA's measures)

1.10 We also asked for feedback on whether exchange-traded futures and similar 'over-the counter' (OTC) products present similar risks of harm to retail consumers, and whether they require similar product restrictions to protect consumers.

Implications of EU withdrawal

1.11 As we explained in our CP, if the UK leaves the EU without a withdrawal agreement, we will act to ensure that our rules capture the same firms and activities as originally proposed in the CP. We made clear in the CP that we will not re-consult if we need to make any changes to final rules simply to maintain their intended scope after EU withdrawal.

1.12 If there is not an implementation period and the passporting regime falls away when the UK leaves the EU, EEA firms who currently passport into the UK and wish to continue operating in the UK will be subject to the temporary permissions regime or the financial services contracts regime (which covers supervised run-off firms and contractual run-off firms).

1.13 Once the UK is no longer subject to EU law, we expect the rules will apply to firms with a temporary permission, supervised run-off firms[4] and contractual run-off firms.[5]

1.14 We may update our rules to include guidance or other clarifications about their scope. Again, we would not expect to re-consult on such changes were we to make them.

4 This is a consequence of proposed rules in GEN 2.2 in the General Provisions Sourcebook (see near final rules in FCA PS19/5) and the EEA Passport Rights (Amendments, etc, and Transitional Provisions) (EU Exit) Regulations 2018 as amended by the Financial Services Contracts (Transitional and Saving Provision) (EU Exit) Regulations 2019.

5 This is a consequence of the EEA Passport Rights (Amendments, etc, and Transitional Provisions) (EU Exit) Regulations 2018 as amended by the Financial Services Contracts (Transitional and Saving Provision) (EU Exit) Regulations 2019.

What we are changing

1.15 We are requiring firms that offer CFDs and CFD-like options to retail consumers to:

- limit leverage to between 30:1 and 2:1 depending on the volatility of the underlying asset
- close out a customer's position when their funds fall to 50% of the margin needed to maintain their open positions on their CFD account
- provide protections that guarantee a client cannot lose more than the total funds in their trading account
- stop offering current and potential customers cash or other inducements to encourage retail consumers to trade
- provide a standardised risk warning, telling potential customers the percentage of the firm's retail client accounts that make losses

1.16 Following feedback to CP18/38, we have amended our rules to:

- clarify the scope of products, activities, and firms caught by our rules
- clarify the methodology for the standardised risk warning, and the ban on monetary and non-monetary benefits
- exclude certain sales activities for CFD-like options

Measuring success

1.17 We expect these measures will reduce harm to retail consumers by ensuring that these CFDs and CFD-like options are not sold with excessive risk features, while still allowing sales to retail consumers who understand the risks and are capable of bearing potential trading losses. Retail consumers are expected to save between £267m and £451m per year from our measures.

1.18 Our intervention in the retail CFD and CFD-like option market will be successful if:

- Fewer retail consumers trade CFDs and CFD-like options, and those that do are more experienced and more capable of bearing potential trading losses
- Total losses from retail consumers trading CFDs and CFD-like options with UK firms is reduced when compared with client outcomes before ESMA's temporary intervention

1.19 We will continue to monitor developments in the market as part of our ongoing supervision of the sector.

Summary of feedback and our response

1.20 We received 28 responses to CP18/38. These responses were from firms, trade bodies, an industry group, retail consumers and EU National Competent Authorities (NCAs). Respondents largely focused on the:

- scope of products caught, specifically that we included CFD-like options
- scope of activities caught by our restrictions

- proposed leverage limits
- use of client assets other than cash as margin collateral
- prominence requirements for the standardised risk warning
- clarity on the interpretation of our rules

1.21 Chapter 2 of this PS summarises this consultation feedback, and outlines our response. Appendix 1 sets out our final rules.

1.22 We received 9 responses to our discussion on whether there is actual or potential harm from futures and other leveraged derivatives products sold to retail consumers. Most respondents argued against expanding the scope of our intervention measures to capture futures and other leveraged products. Having considered feedback, we are not proposing to extend the scope of our intervention measures. We will continue to monitor this market and will re-consider extending the scope of our rules if we see evidence of harm.

1.23 Chapter 3 of this PS summarises feedback to our discussion chapter in CP18/38 and outlines our rationale in more detail.

1.24 Annex 1 lists the names of non-confidential respondents to both CP chapters.

Equality and diversity considerations

1.25 We have considered the equality and diversity issues that may arise from the proposals in this PS. We did not receive any feedback on these considerations during the consultation process.

1.26 Overall, we do not consider that this policy adversely impacts any of the groups with protected characteristics ie age, disability, sex, marriage or civil partnership, pregnancy and maternity, race, religion and belief, sexual orientation and gender reassignment.

Next steps

What do you need to do next?

1.27 If your firm carries out marketing or distribution or selling in, or from, the UK of the relevant products to retail clients, you will be required to comply with the new rules in our Handbook from:

- 1 August 2019 for CFDs
- 1 September 2019 for CFD-like options

What we will do next

1.28 We expect firms to comply with these restrictions. Our supervisory work in this area will likely focus on the following areas of the restrictions:

- attempts to avoid the effect of our new Handbook rules by:
  - inappropriately opting up clients to become elective professional clients

  - moving clients to associated non-UK entities
  - not complying with financial promotion requirements, including the prominence of standardised risk warnings
- firms' prudential soundness including their management of negative balance protection
- firms' treatment of clients in the course of Brexit-related restructuring
- if applicable, the conduct of inward passporting firms operating under the Temporary Permissions Regime

1.29 We will also continue to monitor for any harm to retail consumers relating to exchange-traded futures and similar OTC products.

2 Our response to consultation feedback on proposed restrictions for CFDs and CFD-like options sold to retail clients

2.1 In this Chapter, we summarise the feedback to CP18/38. We also provide our response to views received, including whether we are confirming final rules as proposed or have amended these to reflect consultation feedback.

Overview of responses

2.2 We received 28 responses to the consultation from a range of stakeholders including:

- firms that offer CFDs and CFD-like options, including third country firms
- firms that manufacture CFD-like options
- industry groups representing firms that manufacture CFD-like options
- NCAs[6]
- an association representing law firms
- individuals, including retail consumers and a regulatory compliance consultant

2.3 Respondents queried aspects of our measures, including:

- whether certain products are within scope of our definition of CFDs and CFD-like options
- whether certain activities amount to marketing, distributing and selling, CFD-like options and are caught by the restrictions
- whether the restrictions on CFD-like options prohibited firms in other EEA jurisdictions from selling CFD-like options to retail clients located in the UK if a UK retail client approached a firm outside the UK at their own initiative
- whether tiered-volume fee discounts for all retail clients are prohibited

2.4 We also received arguments opposing aspects of our measures, including that:

- there is insufficient evidence of harm to support the application of measures to CFD-like options
- we should apply higher leverage limits and / or allow experienced retail clients to trade at higher leverage
- we should revise our rules prohibiting the use of assets other than cash as margin collateral to meet margin requirements
- we should not require the risk warning to be fixed and visible at the top of the webpage or mobile application

2.5 Having considered feedback, we continue to consider that overall our measures are appropriate and proportionate. We did not receive compelling evidence that other approaches would better address the identified harm. We are finalising rules that are

6 Article 42 of the Markets in Financial Instruments Regulation (MiFIR) requires us to consult 'Member States that may be significantly affected by the action.'

substantively the same as those we consulted on, including applying our measures to CFD-like options.

2.6 We have, however, made amendments to our rules to clarify the scope and application to certain products or practices. We describe our response to the feedback, and any changes we have made in further detail below.

Scope of products caught

2.7 In CP18/38, we explained that the restrictions would apply to CFDs, spread bets, rolling spot forex products and CFD-like options that are marketed, distributed and sold, by firms in, or from, the UK to retail clients (excluding sports spread bets, as our rules only apply to MiFID financial instruments).[7]

2.8 CFD-like options were not within the scope of ESMA's temporary intervention on CFDs. They are sold under a variety of labels including 'turbo certificates', 'knock out options' and 'delta one options'. As CFD-like options were previously not defined in our Handbook, we proposed a new glossary definition of 'restricted options'.

2.9 CFD-like options have a similar pay-out structure to CFDs, and share common product features. Specifically, they allow retail consumers to gain exposure to a wide range of assets for a fraction of the asset's value. As a result, we think they present the same actual and potential harm to retail consumers. If we did not include CFD-like options, this would allow firms seeking to avoid the restrictions to get around them by manufacturing or offering alternative leveraged derivative products.

Justification for restricting CFD-like options

2.10 Some respondents supported our proposal to capture CFD-like options. They considered that retail consumers should receive consistent regulatory protections based on the risks of the product – particularly the level of leverage offered – rather than whether the product is listed and traded on a trading venue, or traded OTC.

2.11 Two industry bodies that represent firms who represent firms that manufacture, sell and distribute CFD-like options, exchanges that list CFD-like options, and 2 NCAs said that we had not adequately considered how the additional features of CFD-like options reduce the identified harms. They said that the risk of harm is reduced for listed CFD-like options because:

- retail consumers are protected by other existing regulations (eg the Packaged Retail and Insurance-based Investment Products (PRIIPs) Regulation and the Prospectus Directive)
- firms that issue-CFD like options do not benefit from client losses so are not incentivised to act against their clients' best interests
- retail consumers benefit from greater transparency because they are traded on a multilateral trading facility (MTF) or regulated market and are sold with a prospectus

2.12 The Autorité des Marchés Financiers (AMF) (the French NCA) said that it had received limited complaints from retail consumers trading CFD-like options. They suggested

7 They exclude sports spread bets as our rules only apply to MiFID financial instruments.

this shows that retail consumers appear to understand how these products function and have reasonable expectations of their likely performance. The AMF thought this was helped by the additional product features (ie that they are traded on a trading venue and sold with a prospectus) and because they are not marketed aggressively. The AMF noted their supervisory experience was that these products are sold by well-established distributors to a relatively stable and limited retail client-base.

2.13 Finally, the AMF also stated that the use of product intervention powers is a measure of last resort. It should only be considered if supervisory and enforcement tools have been exhausted based on existing rules, such as appropriateness tests. The AMF stated that harmonising the scope and features of national product intervention measures is necessary for efficient supervision and enforcement across the EU.

2.14 The Bundesanstalt für Finanzdienstleistungsaufsicht (BaFin) (the German NCA) recognised our concerns about arbitrage risks of firms seeking to offer CFD-like options to avoid permanent restrictions on CFDs. However, they did not have sufficient evidence of harm in Germany to extend the scope of their national product intervention measures to CFD-like options.

2.15 Industry bodies, exchanges, and manufacturers of CFD-like options also said that applying leverage limits to listed CFD-like options traded on a trading venue is difficult. This is because the intermediary that offers CFD-like options does not know the value of the underlying asset (or the exposure the option provides) at the time of the trade.

2.16 According to 1 UK broker that offers CFD-like options to retail consumers, the price the broker receives is the option's premium (ie the price for gaining exposure to the asset) rather than the value of the underlying asset. This firm said that it would be operationally difficult to administer and apply leverage limits and comply with the margin close out rule. The firm said it would cease offering CFD-like options to retail consumers rather than make the changes necessary to comply with our rules.

Our response

We are confirming final rules that apply to CFD-like options to restrict their marketing, distribution and sale, to retail clients. Having considered feedback, we have concluded that CFD-like options should be subject to our product intervention. The factors highlighted by respondents (either individually or collectively) have not caused us to change our view.

By capturing CFD-like options, our rules ensure that firms do not seek to avoid our CFD measures by offering closely substitutable products. We think that these products pose the same risk of harm as CFDs and that the additional product features of CFD-like options (eg being sold with a prospectus and traded on a trading venue) and existing rules (eg PRIIPs) do not sufficiently reduce their potential harm. We think that leverage poses an inherent risk and that CFD-like options provide access to excessive leverage. So, we think they pose the same risk of harm and will likely lead to similar levels of loss.

As noted in our CP, CFD-like options are not commonly traded by UK retail consumers, nor are they commonly sold by UK firms. However, UK CFD providers have indicated that they intend to offer CFD-like options if

they are not brought within scope of our restrictions. We do not think that supervising against existing rules (eg product governance requirements and appropriateness tests) would adequately address actual and potential harm, and would not be an efficient use of our resources.

We recognise that our rules may impose additional costs on firms that choose to offer CFD-like options. However, we think these measures are necessary to provide appropriate protections for retail consumers. We have considered the additional information provided by firms on costs and concluded that this does not significantly affect our assessment of costs and benefits in CP18/38 (see below for further detail).

We have noted firms' concerns about how our rules interact with existing rules on trading venues. As discussed below, we have modified our rules to address this.

Scope of products caught by our restrictions

2.17 An industry body observed that CFDs within scope of our restrictions were defined by the Regulated Activities Order (RAO). They said that this is potentially wider than ESMA's definition and could capture certain structured products. They also said that unleveraged products (ie where the investor pays the full value of the asset) that provide synthetic exposure to assets should be excluded from the CFD definition.

2.18 We were asked to clarify whether the rules apply to:

- structured capital-at-risk products (SCARPs), as defined in our Handbook
- products with the same features as SCARPs but that guarantee the retail consumer's initial investment

2.19 We were also asked to clarify whether our rules applied to the following derivative instruments:

- so-called 'warrants',[8] and
- constant leverage certificates

2.20 The City of London Law Society (CLLS) also gave feedback on our definition of CFD-like options ('restricted options' in our Handbook). The CLLS said that our definition was uncertain, and risks inadvertently capturing the wrong products. Their feedback focused on the 3 conditions that define CFD-like options.

- 'That is in the money at the point of sale' – CLLS suggested that this would require firms to check whether an option is in the money when the consumer enters the contract, which could be difficult to do.
- 'Where the value is determined by one-to-one fluctuations in the value or price of the underlying asset' – CLLS noted the risk that firms could design options that provide bonus payments to avoid being a 'linear' option and outside the scope of our rules.
- 'For which the value is not significantly affected by time to expiry' – CLLS said this condition could only be met by options where the pay-out is not linked to a strike price. CLLS also questioned how firms can accurately determine the meaning of 'significantly' when assessing whether options fall within scope of our rules.

8 Products described as warrants by the UK SPA are not the same as products that meet the definition of a warrant in our Handbook.

Our response

The final rules remain applicable to restricted speculative investments; namely, CFDs, spread bets, rolling spot forex contracts and restricted options.

The definition of CFD-like options remains unchanged.

We have, however, added the term 'leveraged' to the definition of CFDs, spread bets, and rolling spot forex contracts. This makes clear that unleveraged versions of these products are not within scope of the rules. 'Leveraged' products in this context means products that provide exposure to an asset for a fraction (ie less than 100%) of that asset's value. This helps to clarify the scope of the new rules and ensures we do not capture certain types of CFD that are commonly offered without leverage, such as interest rate swaps.

We have not added the term 'leveraged' to our definition of CFD-like options because we are not aware of any options that do not provide leveraged exposure to an asset.

In terms of whether certain products are caught by our rules given our definition of CFDs and CFD-like options, this will need to be determined on a case by case basis as it will depend on the precise nature of a product.

The term structured product is not a defined term in our Handbook or the RAO. It is used to cover a wide range of products. We understand that most structured products are issued as debt securities, although they often include embedded derivatives. Many products described as structured products also have an entirely different risk profile and economic substance from the types of CFD or CFD-like products that are the focus of this consultation. For example, in many structured products, profit is linked to the performance of one or more underlying assets or indices, either directly or with pay-offs according to a pre-defined formula. The original amount invested in a product is also often guaranteed by the issuer or a group entity (potentially subject to the underlying reference asset(s) remaining within certain limits), which is commonly a bank. They are also not commonly sold with significant leverage. Such structured products are not the focus of our intervention and have been subject to separate FCA work, including Thematic Review (TR) 15/2 (which also described common structured products in Annex 1).

We can confirm that SCARPs (as defined in our Handbook) are not within scope of our rules. CFDs are a subset of the products covered by the defined Handbook term 'derivatives'. Our Handbook is clear that SCARPs are not derivatives, so they are not covered by our new rules. Structured products with the same key features as SCARPs, and which guarantee a minimum return of 100% of initial capital invested, are also outside the scope of our rules.

We understand that constant leverage certificates are derivatives that are priced according to the change in value of the underlying asset over the

course of the trading day. Their pay-out is determined by the difference in price when the market opens compared with when the markets close, or is closed intraday at the initiative of the retail consumer.

We can confirm that constant leverage certificates, as described to us in feedback, are within scope of our rules. This is based on our understanding that their value is determined by reference to fluctuations in the price of the underlying asset. The fact that constant leverage certificates are priced on a daily basis, rather than the difference in price when the contract is opened and closed, does not exclude these products from our rules.

The UK SPA described a 'warrant' as an option that is affected by the time to expiry and the volatility of the underlying asset. This description suggests that the value of these products is not determined by one-to-one fluctuations in the value or price of the underlying asset and is significantly affected by the time to expiry. Products with these characteristics are not within scope of our rules.

We have considered the CLLS' feedback to our definition of restricted options. However, we have decided to finalise the definition we consulted on because we still consider it captures the products we intend and that it is sufficiently clear. In response to the specific points raised by CLLS, we note:

- **That is in the money at point of sale –** The products we intend to capture (eg turbo certificates) are structured to ensure that they are always in the money at the point of sale. For example, by setting the 'knock-out level' equal to the strike price. In practice, it is unlikely that firms will need to assess whether the option is in the money at the point of sale.
- **Where the value is determined by one-to-one fluctuations in the value or price of the underlying asset –** We have not found any options that include bonus payments to avoid these products qualifying as 'linear' options. If firms begin manufacturing products with these features we will consider amending our definition to address any actual and potential harm.
- **For which the value is not significantly affected by time to expiry –** We are aware that some linear options, such as 'deep in the money' options, could be unexpectedly affected by the time to expiry. We believe that these instances are rare and that, in practice, firms will be able to assess whether this condition is met.

As this response has made clear, products can be structured in different ways, many of which are complex. So, it is important to remind firms that the purpose of our new rules is to prevent harm to retail consumers from inappropriate products. We remind firms that they are required to act in the best interests of consumers. Firms are also reminded of their existing product governance obligations when developing new products. Firms are required to have systems and controls in place to design, approve, and manage products throughout the product lifecycle. Good product governance should result in products that:

- meet the needs of one or more identifiable target markets
- are sold to clients in the target markets by appropriate distribution channels
- deliver appropriate client outcomes

We will focus on outcomes in our supervision. We do not expect firms and their senior management to seek to get around our intervention by designing products that, while technically or legally different, lead to the same harms for consumers.

Scope of activities caught

2.21 Industry bodies representing UK and German firms that manufacture and issue CFD-like options, and UK firms that manufacture and issue CFD-like options, requested clarity on the scope of activities caught by our rules. We did not receive similar feedback for CFDs.

2.22 Respondents outlined the process for manufacturing CFD-like options in the UK. According to industry bodies and firms, the activities that UK firms commonly perform include:

- Providing support services to group entities outside the UK that manufacture CFD-like options for sale elsewhere. Support services include technical, legal or tax advice, and risk management activities. One firm indicated that they authorise financial promotions targeted at retail clients located in EEA jurisdictions outside the UK.
- Acting as the issuer, and acting as a market maker for CFD-like options listed on trading venues in EEA jurisdictions primarily outside the UK. When undertaking these activities, UK firms enter into the contract with the retail client but the sale is always concluded through an intermediary. They said those intermediaries are mostly authorised in other EEA jurisdictions.
- UK senior managers having responsibility and oversight for entities outside the UK.

2.23 These respondents said that such products are sold through intermediaries in other EEA jurisdictions and that UK issuers of CFD-like options do not have any direct regulatory relationship with retail consumers (other than being in a contract with a retail consumer). They also said that intermediaries outside the UK are responsible for client onboarding, the execution of client orders, and are mostly responsible for financial promotions.

2.24 Respondents said that if the proposed rules were applied to UK firms selling CFD-like options under these circumstances, they would be difficult to apply in practice because they do not have a direct relationship with the retail client. In particular, issuers could not apply leverage limits or the margin close out rules because they cannot see the funds in the retail consumer's account. They also indicated that the rules would disrupt their existing business and they may have to close EU retail clients' open positions, which could cause harm to consumers. They indicated that they would need more than 2 months to comply with our rules and limit disruption to existing retail consumers.

2.25 Respondents said that they understood that our restrictions were intended to provide protections for UK retail consumers and apply to intermediaries / distributors rather than what they consider to be manufacturers. They indicated that our CBA only identified 2 firms that sell CFD-like options and did not assess expected costs for UK wholesale

banks that manufacture these products for sale in other EEA jurisdictions on EU trading venues.

2.26 It was suggested that issuers who do not have an active role in onboarding retail consumers or concluding the sale of these products should not be subject to our rules. Instead, the rules should only apply to firms that are actively involved at the point of sale (ie the intermediary).

2.27 We did not receive similar feedback regarding CFDs. We are not aware of UK firms that manufacture, issue or sell CFDs to retail clients through intermediaries that are not subject to ESMA's temporary restrictions or our final rules.

2.28 ESMA, NCAs and an industry body requested clarity on the territorial scope of our rules. They asked whether the restrictions on CFDs and CFD-like options prohibited firms in other EEA jurisdictions from selling CFDs and CFD-like options to retail clients located in the UK if those clients approached a firm outside the UK at their own initiative.

2.29 Since we consulted, ESMA has published guidance on the application of national product intervention measures under Article 42 of MiFIR.[9] This includes how firms should comply where EEA states apply different measures.

Our response

Article 42 of MiFIR is a unique power that enables Member States to impose restrictions on how MiFID financial instruments are marketed, distributed and sold in that jurisdiction. Article 42 does not make a distinction between home and host state requirements, as certain provisions in MiFID II do.

As consulted on, our rules apply to UK and EEA MiFID investment firms. This includes firms that are operating on a services-only passport from one EEA Member State, selling products to clients in another EU member state. This means that where a firm in one EEA state sells products to a consumer in another EEA state and both states have adopted product intervention rules for those products, then both sets of rules apply to the firm.

ESMA's guidance explains that where one EEA state applies national intervention measures that are stricter than another EEA state's measures, then the stricter rules apply. We have amended our rules to ensure that, if a firm is dealing with a retail client in another EEA state that has adopted rules covering the same activity, our rules do not apply where the other state's rules are stricter. This will avoid firms being subject to conflicting obligations.

In practice, UK firms, and UK branches of EEA and third-country investment firms, should comply with our rules when marketing, distributing and selling CFDs to retail clients in:

9 National product intervention measures are applied under Article 42 of MiFIR.

- the UK
- third countries
- EEA member states that have:
  - not applied permanent product intervention measures, or
  - adopted less strict permanent product intervention measures

Firms offering CFDs to retail clients in EEA member states that have applied the same measures as ESMA on a permanent basis will need to:

- limit leverage to 5:1 for CFDs referencing certain government bonds
- if they are a new firm that does not have 12 months of retail client trading data, give ESMA's standardised risk warning disclosing the percentage of client accounts that lose money trading CFDs according to NCAs' studies

Based on the rules we consulted on, when a firm sells a CFD-like option to a retail client through an intermediary, and is therefore in a contract with the retail client, the firm would have been within scope of our restrictions.

We did not intend to capture firms that manufacture CFD-like options for sale through intermediaries outside of the UK where the firm enters in to the contract with the retail consumer without any other direct regulatory relationship (ie does not onboard the client, conduct an appropriateness assessment etc). So, we have amended our rules to exclude firms who sell CFD-like options to retail clients when the product's sale is intermediated by another firm outside of the UK. This would also exclude market making from scope in the circumstances above. Our rules do not exclude firms when the sale is not intermediated, including when the retail client is a direct market participant on an MTF or a regulated market.

Our final rules will apply to intermediaries that have a direct relationship with retail clients (ie at the point of sale) that market, distribute or sell CFD-like options to a retail client in or from the UK.

Support services, including technical, legal or tax advice, and risk management activities, are not within scope of our rules. Firms that communicate or approve a financial promotion in or from the UK for CFD-like options sold to retail clients are subject to our rules, regardless of where that retail client is located.

Our rules prevent any firm (UK or non-UK) from marketing CFD-like options to UK clients. However, we did not think it would be proportionate, practical or effective to seek to apply our rules to overseas firms, including EEA firms, not supervised by the FCA and subject to different rules in their own jurisdiction. Therefore, where a UK-based client contacts an overseas firm on their own initiative, that firm may still sell those products, if they are permitted in their own jurisdiction.

We have not extended the same exclusion to UK firms. This is because, as noted above, CFD-like options are not commonly traded by UK retail consumers, nor are they commonly sold by UK firms. However, UK CFD providers have indicated that they would offer CFD-like options if they are not brought within scope of our restrictions. Our rules will reduce actual

and potential harm to UK retail consumers from firms seeking to avoid our CFD restrictions by offering new products with similar risk features. As noted below, our restrictions on CFD-like options will cause disruption to at least one firm's business, but this has not caused us to change our CBA. Applying our rules to firms outside the UK (where they provide a CFD-like option as a result of an approach from a retail client) would impose implementation costs for EEA firms that are not justified by the benefits to UK consumers. We will continue to monitor developments in the CFD-like option market. If there is evidence of harm, we will amend our rules to prohibit all firms from selling CFD-like options without restrictions to retail clients located in the UK in any circumstances.

By contrast, as outlined above, UK firms selling CFDs to retail clients must ensure that they comply with the national product intervention measures of the member state where the retail client is located, if those measures are stricter, even where that retail client approaches a UK firm at their own initiative. Our CFD restrictions apply to all firms that market, distribute or sell CFDs to retail clients in the UK, unless the firm's home member state has applied stricter measures. This includes when a UK retail client approaches a non-UK based EEA firm at their own initiative. In the case of CFDs, unlike CFD-like options, we think this is a proportionate approach. This is because there is a greater risk of harm, and because EEA firms will incur implementation costs anyway due to their home NCA's measures.

Based on the amendments to our rules, we have concluded that we do not need to update the CBA.

Leverage limits

2.30 We proposed leverage limits between 30:1 and 2:1 for CFD and CFD-like options. Our proposed leverage limits only differed from ESMA's temporary leverage limits for CFDs referencing certain government bonds, which we have set at 30:1 compared with 5:1 under ESMA's measures.

Application of different leverage limits

2.31 Firms argued that the introduction of ESMA's leverage limits has not improved client outcomes. Various arguments or unintended consequences were cited, including that:

- ESMA's leverage limits did not reduce the percentage of loss-making client accounts.
- Consumers profiting from CFD trading, made lower profits following the introduction of lower leverage.
- Continued demand for higher leverage limits will drive retail consumers to either:
  - seek out unregulated entities or firms based in third country jurisdictions to trade unrestricted CFDs, losing regulatory protection offered, or
  - opt-up to become an elective professional client, resulting in consumers receiving fewer protections.
- It was too early to analyse the impact of ESMA's interventions.
- Incorrect assumptions were used to set leverage limits.

2.32 One firm acknowledged that, although the percentage of loss-making accounts was the same following ESMA's interventions, in aggregate retail consumers were losing less money.

2.33 One respondent suggested that retail consumers should be banned from trading any leveraged products.

2.34 Some firms said that we should apply different categories within existing asset categories (eg major indices) for assets with common levels of volatility or that certain assets should be re-categorised and subject to higher leverage limits because they are less volatile compared with other assets. One firm said that we should apply different leverage limits to different subsets of equities to reflect the relative volatility of different equities. Another firm said that the Spanish Continuous Exchange Index (IBEX) should be categorised as a major rather than a minor index.

2.35 One firm said that leverage limits should be aligned to a sensible market reference (eg margin for exchange-traded futures). They also suggested that our leverage limits should be more granular to capture other assets (eg bonds). Two firms suggested that they should be able, voluntarily, to increase margin requirements in response to periods of higher volatility; one firm thought this should be mandatory. One firm requested clarity on whether they can increase margin requirements for open positions. The firm typically notifies clients with open positions 2–3 days before any open positions are closed out, although the notification period varies depending on the volatility of the asset.

2.36 Firms were supportive of our proposal to set leverage limits for CFDs for certain government bonds according to their relative volatility (ie leverage limits of 30:1 compared with 5:1 under ESMA's restrictions).

Higher leverage limits for experienced retail clients

2.37 A number of respondents argued that we should reinstate our previous proposal (in CP16/40) to create an 'experienced' retail client category that allows retail consumers with 12 months CFD trading experience to trade at higher leverage levels than inexperienced clients. Feedback to CP16/40 suggested that checking the experience of clients would be costly and burdensome to implement, however this time several respondents said the costs were acceptable.

2.38 Respondents favouring this approach said that it will allow firms to differentiate between levels of knowledge, experience, and wealth among UK retail clients. They said that retail consumers who understand trading risks should be able to access higher leverage. Some respondents argued that such consumers would continue to benefit from the additional protections retail clients are afforded, which they would lose if they became an elective professional client or traded with a third country provider.

2.39 Some respondents said that the criteria to become an elective professional client is too high. Firms suggested that experienced retail clients should receive up to 200:1 leverage for the least volatile assets (eg major FX pairs).

Our response

We have finalised our leverage limits as consulted on. Evidence from ESMA's intervention, which applied leverage limits that are mostly the same as those we consulted on, has reduced client losses by £77m between August 2018 and October 2018, equal to a projected reduction of £309m per year.

Our own independent analysis concluded that leverage limits will save consumers between £259m and £443m per year. We think that leverage limits will have the same impact on client outcomes for CFDs and CFD-like options as the risk of harm from higher leverage is consistent across product types. We note, however, that current volumes of trading in CFD-like options are lower than those in CFDs.

We did not receive any feedback that led us to reassess the benefits of our proposed leverage limits nor that the reinstatement of the experience category as consulted on in CP16/40 would be more beneficial to consumers. We recognise that the percentage of loss-making retail client accounts may not improve and that profitable trades may be less profitable when trading at lower leverage. However, we expect that retail consumers will experience lower total losses from trading than if we allowed higher leverage limits. Our analysis did not suggest that retail clients with more experience trading CFDs would benefit from higher leverage (ie that they would lose less money), and we did not receive evidence that they would.

The number of active retail clients trading with UK CFD providers has decreased since ESMA's intervention in August 2018. A proportion of these clients may have moved to third country providers to access higher leverage. We recognise this risk, but do not think that the existence of lower conduct standards in third country jurisdictions justifies lower conduct standards in the UK. We will continue to work with third country jurisdictions and the International Organisation of Securities Commissions (IOSCO) to promote consistent global standards or good practices that reduce harm.

We have considered whether adopting different leverage limits for certain asset classes, or re-categorising assets, would be appropriate. We recognise the benefits of applying leverage limits according to a market reference (eg initial margin requirements in futures markets). However, we have concluded that this would be difficult and costly for us to supervise. So, we have concluded that this approach would not be proportionate.

We also recognise that some assets may be less or more volatile than the current prescribed leverage limits. However, the overwhelming majority of assets that are most commonly traded by retail consumers are consistent with our prescribed model for setting leverage limits. So, we have not amended the current asset categories and their associated leverage limits.

Our rules allow firms to set lower leverage limits (increase margin requirements) in response to periods of greater volatility. Firms can also amend / increase margin requirements for open positions, but should consider the best interests of retail clients if they do.

We expect firms to provide consumers with a reasonable notification period if they require additional margin from the client to avoid positions being unexpectedly closed out by the firm.

The use of client assets other than cash as margin collateral

2.40 In our CP we stated that, if provided responsibly, the use of retail client assets (other than cash) as margin collateral could be appropriate for a sub-set of retail consumers. We said that we were open to suggestions for potential rules that could appropriately balance the risks and benefits of this practice for consumers to ensure it does not lead to harm.

2.41 Three firms said that we should allow firms to use client assets other than cash as margin collateral under certain circumstances. One firm said that this would be beneficial to consumers because it will lower the cost for retail consumers that wish to hedge their investment portfolio. Prohibiting this imposes unnecessary costs by forcing consumers to forego interest and other returns on assets (eg if a consumer had to sell other assets to provide cash for CFD trading).

2.42 All firms agreed that assets held for retirement savings or other long-term investments should not be permitted for use as collateral for CFD margins. One firm said that the client should be able to determine how much of their non-cash assets are at risk.

Our response

We received feedback suggesting that an exemption to allow firms to use client assets other than cash as margin collateral may be beneficial for some retail consumers. In response, we considered an appropriate set of protections that would secure the benefits and mitigate the risks of this practice (eg by limiting this facility to retail clients earning over £100,000 per year and with £25,000 in assets held with the firm).

However, we have concluded that although this measure may benefit a small sub-set of retail clients, they would be complex for firms to put in place, and for us to supervise, and the resulting benefits would not outweigh the risk of harm to consumers from providing this exemption.

Margin close out rule

2.43 In CP18/38, we proposed a rule to standardise market practice. The rule requires firms to close out a retail client's position when their funds fall to 50% of the margin needed to maintain their open CFD or CFD-like option positions on their CFD account.

2.44 No respondents opposed this measure. However, some firms sought clarity on whether the draft rule allowed them to close out a retail client's position(s) before the net equity of the retail consumer's account reached 50% of the margin required (eg at 70% of the initial margin required).

Our response

We have finalised our rules as consulted on. Our rule sets a minimum, rather than a prescribed, percentage and so allows firms to close out client accounts at a higher percentage than 50% of the initial margin required if they wish. However, we expect firms to make clear to clients the terms and conditions applied to their account in all cases.

Negative balance protection

2.45 We proposed to require firms to guarantee that retail clients cannot lose more than the funds in their CFD trading account.

2.46 Most respondents agreed with the measure. One respondent said that it was a useful feature that the FCA should encourage, but it should not be a compulsory requirement. Another respondent agreed with the proposal only if it is accompanied by higher leverage limits.

2.47 Some respondents expressed concerns about the measure. Two respondents said that retail consumers might abuse negative balance protection by opening off-setting positions on different accounts ahead of significant and expected market events.

2.48 A third country firm suggested that the cost of providing negative balance protection would result in wider spreads (eg higher trading costs). This could lead to higher losses for retail consumers. The same respondent also suggested that the measures would prevent brokers from hedging retail consumers' trades with external counterparties.

Our response

Having considered feedback, we have finalised our rules as consulted on as we consider this measure to be appropriate and proportionate.

Negative balance protection is expected to save retail consumers £6m per year.

As explained in the CP, we consider that firms should be able to detect abusive strategies through existing surveillance and monitoring

systems. We still think that the benefits of addressing consumer harm through negative balance protection outweigh the risks to firms. We did not receive evidence that higher leverage supported by negative balance protection would benefit retail consumers.

Ban on monetary and non-monetary benefits

2.49 We proposed banning all monetary and non-monetary benefits (excluding information and research tools) that incentivise retail clients to trade CFDs. We said that price discounts offered to all retail consumers were not considered a monetary benefit. However, volume-based rebates were within scope of the ban as they encouraged consumers to trade at higher volumes, resulting in higher losses.

2.50 Several firms questioned whether tiered volume fee discounts are within scope of the ban. One firm stated that a ban on such discounts would discriminate between different products that can be used for similar purposes. Tiered fees (spreads) differ from volume-based rebates as they are 'stepped'. This means that consumers do not receive a rebate or discount for their previous trades, but benefit from lower transaction costs for new trades once a specified trading volume has been reached (eg £1m total volume). This is common practice in other markets.

2.51 Another firm said that it did not agree with our statement in the CP that higher trading volumes are correlated with higher losses. One firm suggested that instead of banning monetary and non-monetary benefits, we should require firms to guarantee that retail consumers can withdraw their funds at any time.

Our response

As noted in our CP, a ban on monetary and non-monetary incentives would address the risk of these incentives distracting retail consumers from the risks and complexity of CFDs and CFD-like options. We did not receive any information that led us to re-assess the benefits of this policy measure. So, we are proceeding with rules to ban the offer of monetary and non-monetary incentives when firms offer CFDs and CFD-like options to retail consumers.

We do not think that tiered volume fee discounts incentivise retail clients to trade at higher volumes. This is because tiered volume fee discounts do not create a 'cliff-edge' effect as consumers do not receive a rebate payment for past trades when they reach a specified trading volume. We also accept that prohibiting this practice could place CFD firms at a competitive disadvantage to other financial services firms and unnecessarily limit competition based on different fee models.

We recognise that our guidance suggested that tiered-volume discounts are prohibited. We have addressed this by amending our guidance by removing the reference to 'not linked to volumes.'

Risk warning

2.52 We proposed requiring firms to provide a standardised disclosure to retail consumers. The disclosure outlines the key risks of trading CFDs and requires the firm to disclose the percentage of loss-making retail client accounts over the previous 12 months.

2.53 Some respondents suggested alternatives to our proposed risk warning. One respondent suggested requiring firms to provide the percentage of positions hedged or the percentage of client trades that are 'stopped out' would be more informative. Another respondent suggested firms should disclose the average value of client losses, or the distribution of consumer losses and profits across their entire client basis. One respondent was concerned that disclosing the percentage of loss-making retail consumer accounts could distort competition between CFD firms by suggesting that client performance is due to the firm as opposed to the performance of the underlying market.

2.54 One respondent said that active retail client accounts that experience no change in value should be treated as profit-making accounts, aligning our methodology with ESMA's temporary intervention measures.

2.55 Several firms argued that our requirement to place the standardised risk warning at the top of the webpage would disrupt the consumer's experience, impose unnecessary implementation costs, and provide limited additional benefits to consumers. Two firms said that the risk warning should be at the bottom of the webpage.

2.56 A few respondents said that firms' risk warnings under ESMA's rules have not been sufficiently prominent. They also suggested that our risk warnings should describe the risks of trading CFDs even more starkly (eg by describing them as gambling products).

2.57 We consulted on a different risk warning than ESMA's for new firms that do not have 12 months of retail client trading data. Our warning did not require firms to disclose the percentage of loss-making client accounts based on studies conducted by other NCAs. Instead, firms would be required to state: 'The majority of retail investor accounts lose money when trading CFDs.' Austria's Finanzmarktaufsichtsbehörde (FMA) adopted a similar approach, requiring new firms to provide a standardised risk warning that states 'The vast majority of retail client accounts lose money when trading in CFDs.'

Our response

We have finalised our rules as consulted on, with only minor amendments. We have amended our rules for the standardised risk warning to:

- Align the methodology for calculating loss-making accounts with ESMA's (ie if an active retail account that experiences zero change in value over a period it will be counted as a profit-making account). This will avoid any unnecessary implementation costs for firms.
- Align our risk warning for new firms with the Austrian FMA's risk warning. We think this warning better reflects the risks of trading CFDs and will avoid any unnecessary implementation costs for firms.
- Require firms to modify the standardised risk warning to include 'CFD-like options' if the firm sells these products alongside CFDs.

We think that the final risk warning contains the key information necessary for retail consumers to make an informed decision on whether to open an account and trade CFDs and CFD-like options. Responses to the CP have not provided evidence to change our view.

Our proposed rules requiring firms to provide the standardised risk warning at the top of the webpage is consistent with the FCA's existing expectations of firms as outlined in our 2011 guidance on prominence. We expect firms to follow this guidance. Requiring firms to provide the standardised risk warning at the top of the webpage is intended to draw the retail consumer's attention to the risks of trading and ensure it is appropriately considered.

The FCA is currently working with academic researchers to assess the effectiveness of the prominence of risk warning via webpages. We will consider amending our rules if this research concludes that risk warnings provided at the top of the webpage do not improve investors' understanding and memory of risk factors associated with certain investment products.

Cost benefit analysis

2.58 In CP 18/38, we set out our cost benefit analysis (CBA) of our proposed intervention, as required by section 138I(2)(a) of the Financial Services and Markets Act 2000. We received the following feedback to our CBA.

2.59 Some respondents argued that for UK firms that manufacture and sell CFD-like options through intermediaries (mostly outside the UK), our rules would impose significant additional costs that were not considered in the original CBA. These costs were not quantified. Our final rules exclude firms selling CFD-like options to a retail client, but only where the product's sale has occurred through an intermediary. So, we have concluded that our rules do not impose additional costs on these firms.

2.60 Feedback also suggested that our restrictions on CFD-like options will cause disruption to 1 firm's business. Based on their estimate of these costs, we have concluded that this does not significantly affect the figures we gave in the CBA.

2.61 Some firms said that our rules for the standardised risk warning, which requires firms to display the risk warning at the top of the webpage, would impose additional costs. However, we would already expect firms to be following existing guidance on prominence (as noted above). Further, the benefits of our final rules are expected to outweigh the costs to firms.

2.62 We have also made some refinements to our final rules. These changes will not impose significant additional costs on firms or consumers.

2.63 Based on the amendments to our rules, we have concluded that we do not need to update the CBA.

3 Our response to feedback on our discussion on futures and other leveraged derivatives products

3.1 In this Chapter, we summarise the feedback received to our discussion on policy considerations for futures and other leveraged derivatives products in CP18/38. We also indicate our response and next steps.

Overview of responses

3.2 We received 9 responses to the discussion section in CP18/38 including:

- 2 from specialist CFD providers
- 2 from firms that offer CFDs, CFD-like options and futures to retail clients
- 2 from derivatives exchanges
- 1 from a futures broker that offers futures to retail clients
- 1 from an industry body representing the futures industry
- 1 from an industry body representing investment managers and financial advisors

3.3 Most respondents opposed the possible extension of product intervention measures to capture futures and similar leveraged derivatives products. However, some respondents did support the possible extension.

Responses opposing an extension to futures and other leveraged derivative products

3.4 Respondents opposing the application of similar product intervention measures to futures and other leveraged products stated that there is insufficient evidence of harm.

3.5 These respondents stated that futures are responsibly distributed to a sub-set of comparatively wealthy and sophisticated retail clients who predominantly use futures to hedge their wider investment portfolio.

3.6 One respondent indicated that their clients use exchange-traded futures and options for speculative purposes and that their investment horizon is typically short-term (defined as 3 months or less).

3.7 Respondents suggested that futures are distributed to an appropriate target market for the following reasons:

- They are not aggressively marketed to the mass retail market. One respondent said they do not market futures. Instead, they rely on retail clients approaching the firm at their own initiative and referrals by existing customers.

- A few respondents said that futures brokers apply robust standards when conducting appropriateness assessments. According to 1 firm, 95% of their retail clients passed the appropriateness test and only 5% of their clients failed the appropriateness test and proceeded to trade following an enhanced risk warning. The percentage of clients that passed the appropriateness test is significantly higher compared with CFD firms, as discussed in CP18/38.
- One respondent said that retail consumers face higher barriers to entry because futures typically provide a larger exposure because they are commonly traded in higher value minimum lot sizes. This requires retail consumers to take larger positions and so post more margin than required for a comparable CFD contract.
- Another respondent said that most firms ceased offering these products on a non-advised basis (ie execution only) in response to incoming reforms under MiFID II and PRIIPs. These reforms enhanced existing requirements that seek to ensure that investment products are sold to an appropriate target market, considering their risks, costs, and complexity.

3.8 Respondents also said that retail consumers benefit from better quality execution and lower counterparty risk for derivatives that are centrally-cleared and traded on a trading venue.

3.9 We did not receive evidence to suggest that firms commonly offer futures with significantly higher leverage than that available for CFDs. 1 firm said they did not offer intra-day margin discounts for futures. Another firm indicated that they do. They believed that intra-day margin discounts do not unreasonably add to the risks if these discounts are only available intra-day.

3.10 A few respondents said that it would be difficult for brokers to collect initial margin equal to 110% of the minimum margin required by the central counterparty (CCP). This is because CCPs do not commonly know the margin collected for individual clients per trade. One respondent said that requiring brokers to provide negative balance protection for futures might conflict with rules in third country jurisdictions that are designed to promote financial stability.

Responses supporting an extension of rules to futures and other leveraged derivative products

3.11 Respondents supporting the application of similar product intervention measures to futures and other leveraged products said that all products that have the same or similar features to CFDs that are offered to retail clients should be subject to the same rules.

3.12 These respondents said that futures posed the same risk of harm to retail consumers as CFDs and that there was a significant risk that firms will begin offering futures with higher leverage than CFDs if we did not extend the scope of our rules. They also said that firms should compete on a 'level playing field'.

Our response

Having considered feedback, we are not proposing to apply intervention measures to restrict how futures and other leveraged derivative products are sold to retail clients at this time. This is because, according to firm feedback and our own market intelligence, futures and other leveraged derivative products are sold on similar terms to CFDs under conditions that are similar to our final rules (eg they are generally not offered with excessive leverage). Where sold to retail consumers, this appears to be predominantly to consumers who are able to understand the risks of trading and are capable of bearing losses, and are more likely to be used for hedging purposes.

We are concerned that firms offer, or may consider offering, futures with higher leverage than what is now available for CFDs by offering intra-day margin discounts. As indicated in our statement on selling high-risk speculative investments to retail clients following ESMA's action on CFD products, we know that other products can create the same kinds of risks to consumers as CFDs. This is particularly where they expose retail consumers to significant leverage.

As demonstrated by our analysis of the impact of leverage on client outcomes in CP18/38, higher leverage is associated with higher losses from trading. Based on this analysis, we consider leverage limits that are broadly similar to those available for retail consumers trading CFDs and CFD-like options provide appropriate protections for retail clients trading leveraged derivative instruments. We understand that most firms apply margin requirements to futures that are not significantly different from those required for CFDs. However, firms that offer intra-day margin discounts or other mechanisms to provide higher leverage to retail consumers are unlikely to be acting in the best interests of their clients and should amend their products accordingly.

We will continue to monitor developments in the retail market for futures and other leveraged derivatives, and will intervene if there is evidence of harm.

Annex 1
List of non-confidential respondents

AMT Futures Limited

Autorité des Marchés Financiers (AMF)

Bundesanstalt für Finanzdienstleistungsaufsicht (BaFin)

5 retail consumers

ADS Securities London Limited (ADSS)

The Australian CFD & FX Association

Baden-Württembergische Wertpapierbörse GmbH

The City of London Law Society (CLLS)

Compound Growth Limited

Deutscher Derivate Verband (DDV) (German Derivatives Association)

Fairmarkets Trading Pty Ltd

Go Markets Pty Limited

ICE Futures Europe

Interactive Brokers (UK) Limited

Pepperstone Group Limited

Saxo Capital Markets UK Limited

UK Structured Products Association (UK SPA)

Annex 2
Abbreviations used in this paper

AMF	Autorité des Marchés Financiers
BaFin	Bundesanstalt für Finanzdienstleistungsaufsicht
CBA	Cost Benefit Analysis
CFD	Contracts for Differences
CP	Consultation Paper
CRD	Capital Requirements Directive
DP	Discussion Paper
EEA	European Economic Area
ESMA	European Securities Markets Authority
EU	European Union
FCA	Financial Conduct Authority
FMA	Finanzmarktaufsichtsbehörde
FX	Foreign Exchange
IBEX	Spanish Continuous Exchange Index
IOSCO	International Organisation of Securities Commissions
MiFID II	Markets in Financial Instruments Directive II
MiFIR	Markets in Financial Instruments Regulation
MTF	Multilateral Trading Facility
NCA	National Competent Authority
OTC	Over-the-counter
PRIIPS	Packaged Retail and Insurance-based Investment Products Regulation
PS	Policy Statement
RAO	Regulated Activities Order

SCARPs	Structured capital at risk products
UK	United Kingdom

We have developed the policy in this Policy Statement in the context of the existing UK and EU regulatory framework. The Government has made clear that it will continue to implement and apply EU law until the UK has left the EU. We will keep the proposals under review to assess whether any amendments may be required in the event of changes in the UK regulatory framework in the future.

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Appendix 1
Made rules (legal instrument)

CONDUCT OF BUSINESS (CONTRACTS FOR DIFFERENCE) INSTRUMENT 2019

Powers exercised

A. The Financial Conduct Authority ("the FCA") makes this instrument in the exercise of the following powers and related provisions in the Financial Services and Markets Act 2000 ("the Act"):

(1) section 137A (The FCA's general rules);
(2) section 137D (FCA general rules: product intervention);
(2) section 137R (Financial promotion rules);
(3) section 137T (General supplementary powers); and
(4) section 139A (Power of the FCA to give guidance).

B. The rule-making provisions listed above are specified for the purposes of section 138G(2) (Rule-making instruments) of the Act.

C. The FCA also makes the restrictions contained within this instrument in the exercise of the power under article 42 of Regulation (EU) No 600/2014 of the European Parliament and of the Council of 15 May 2014 on markets in financial instruments and amending Regulation (EU) No 648/2012.

Commencement

D. Part 1 of Annex A and Part 1 of Annex B of this instrument come into force on 1 August 2019.

E. Part 2 of Annex A and Part 2 of Annex B of this instrument come into force on 1 September 2019.

Amendments to the Handbook

F. The Glossary of definitions is amended in accordance with Annex A to this instrument.

G. The Conduct of Business sourcebook (COBS) is amended in accordance with Annex B to this instrument.

Citation

H. This instrument may be cited as the Conduct of Business (Contracts for Difference) Instrument 2019.

By order of the Board
27 June 2019

Annex A

Amendments to the Glossary of definitions

In this Annex, underlining indicates new text and striking through indicates deleted text, unless otherwise indicated.

Part 1: Comes into force on 1 August 2019

Insert the following new definitions into the appropriate alphabetical positions. The text is not underlined.

major foreign exchange pair	two different currencies from the following list of currencies: US dollar, euro, Japanese yen, pound sterling, Canadian dollar and Swiss franc.
major stock market index	one of the following stock market indices: (a) Financial Times Stock Exchange 100 (FTSE 100); (b) Cotation Assistée en Continu 40 (CAC 40); (c) Deutsche Bourse AG German Stock Index (DAX 30); (d) Dow Jones Industrial Average (DJIA); (e) Standard & Poor's 500 (S&P 500); (f) NASDAQ Composite Index (NASDAQ); (g) NASDAQ 100 Index (NASDAQ 100); (h) Nikkei Index (Nikkei 225); (i) Standard & Poor's/Australian Securities Exchange 200 (ASX 200); or (j) EURO STOXX 50 Index (EURO STOXX 50).
minor foreign exchange pairs	a pair of two different currencies whose exchange rates are traded in the foreign exchange market which is not a *major foreign exchange pair*.
minor stock market index	a stock market index which is not a *major stock market index*.
relevant sovereign debt	a debt issuance, issued by or on behalf of: (a) the government of the *United Kingdom*;

(b) the Scottish Administration;

(c) the Executive Committee of the Northern Ireland Assembly;

(d) the National Assembly of Wales;

(e) a member state of the *EU* that has adopted the euro as its currency;

(f) the United States of America;

(g) Japan;

(h) Canada; or

(i) Switzerland.

restricted speculative investments any of the following *investments*:

(1) leveraged *contracts for differences*;

(2) leveraged *spread bets*; and

(3) leveraged *rolling spot forex contracts* (other than a *future* falling within limb (a) of the *Glossary* definition of *rolling spot forex contract*),

but only where such *investments* are *financial instruments*.

Amend the following definitions as shown.

commodity …

(2) (for the purpose of calculating *position risk requirements* <u>and for the purposes of *COBS* 22</u>) any of the following (but excluding gold):

…

…

margin <u>(1)</u> (in *COLL*) cash or other property paid, transferred or deposited under the terms of a *derivative*; for these purposes cash or property will be treated as having been paid, transferred or deposited if it must be paid, transferred or deposited in order to

comply with a requirement imposed by the market on which the contract is made or traded.

(2) (in *COBS* 22) cash transferred or deposited under the terms of a *derivative*; for these purposes cash will be treated as having been paid, transferred or deposited if it must be paid, transferred or deposited in order to comply with a requirement imposed by the market on which the contract is made or traded.

Part 2: Comes into force on 1 September 2019

Insert the following new definition in the appropriate alphabetical position. The text is not underlined.

restricted option an *option*:

(1) that is *in the money* at the point of sale;

(2) where the value is determined by one-to-one fluctuations in the value or price of the underlying asset; and

(3) for which the value is not significantly affected by the time to expiry.

Amend the following definition as shown.

restricted speculative investments any of the following *investments*:

(1) leveraged *contracts for differences*;

(2) leveraged *spread bets*; ~~and~~

(3) leveraged *rolling spot forex contracts* (other than a *future* falling within limb (a) of the *Glossary* definition of *rolling spot forex contract*); and

(4) *restricted options*,

but only where such *investments* are *financial instruments*.

Annex B

Amendments to the Conduct of Business sourcebook (COBS)

In this Annex, underlining indicates new text and striking through indicates deleted text, unless otherwise stated.

Part 1: Comes into force on 1 August 2019

4 Communicating with clients, including financial promotions

…

4.7 Direct offer financial promotions

…

4.7.6 R …

4.7.6A G *Firms* are reminded of their obligations in relation to the marketing, distribution and sale of *restricted speculative investments* in *COBS* 22.5.

…

22 Restrictions on the distribution of certain complex investment products

…

Insert the following new section, COBS 22.5, after COBS 22.4 (Prohibition on the retail marketing, distribution and sale of derivative contracts of a binary or other fixed outcomes nature). The text is not underlined.

22.5 Restrictions on the retail marketing, distribution and sale of contracts for differences and similar speculative investments

Application

22.5.1 R (1) Subject to (2), this section applies to:

(a) *MiFID investment firms* with the exception of *collective portfolio management investment firms*; and

(b) *branches* of *third country investment firms*,

in relation to the marketing, distribution or sale of *restricted speculative investments* in or from the *United Kingdom* to a *retail client*.

(2) This section does not apply to the marketing, distribution or sale of

restricted speculative investments to a *retail client* in another *EEA State* to the extent that those activities are subject to stricter requirements imposed under article 42 of *MiFIR* by the *competent authority* of that *EEA State*.

22.5.2 G The *rule* in *COBS* 22.5.1R(2) means that a *firm* does not need to comply with the *rules* in this section to the extent that the marketing, distribution or sale by that *firm* is subject to a stricter requirement in the *retail client's* state. For instance:

(1) Where a *firm* sells a *restricted speculative investment* to a *retail client* in an *EEA State* (A) and A has imposed stricter margin requirements for *retail clients* than those in this section, but the remainder of the requirements imposed by A are the same or less strict than those in this section, then the *firm* should comply with the stricter margin requirements imposed by A but should still comply with the remainder of the *rules* in this section.

22.5.3 G *Firms* are reminded that the *Glossary* definition of *MiFID investment firm* includes *CRD credit institutions* when those institutions are providing an *investment service* or *activity*.

22.5.4 G For the avoidance of doubt, "marketing" *restricted speculative investments* includes *communicating* and/or *approving financial promotions*, and "distribution or sale" includes *dealing* in relation to *restricted speculative investments.*

22.5.5 R The *rules* in this section do not apply to *derivative* instruments for the transfer of credit risk to which article 85(3) of the *Regulated Activities Order* applies.

Standardised risk warning

22.5.6 R (1) Subject to *COBS* 22.5.7R, a *firm* must not:

(a) market, publish, provide or communicate in any other way any communication or information in a *durable medium* or on a webpage or website to a *retail client*, or in such a way that it is likely to be received by a *retail client*;

(b) *approve* or *communicate* a *financial promotion* in a *durable medium* or on a webpage or website; or

(c) disseminate such a communication, information or *financial promotion* to a *retail client*, or in such a way that it is likely to be received by a *retail client*,

unless the *firm* includes the following 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."

(2) The risk warning must be modified as necessary to refer to the percentage of *retail client* accounts that lost *money* relevant to the *firm*.

(3) The *firm's* disclosure of the percentage of *retail client* accounts that lost *money* must include an up-to-date percentage based on a calculation of the percentage of *retail client* accounts held with the *firm* that lost *money*.

(4) The calculation in (3) must be performed every three *months* and cover the 12-*month* period preceding the date of the calculation.

(5) For the purposes of the calculation in (3), an individual *retail client* account must be considered to have lost *money* if the sum of all realised and unrealised net profits on *restricted speculative investments* traded in that *retail client's* account during the 12-*month* calculation period is below zero.

(6) The calculation in (3) must include all costs, fees, *commissions* and any other charges.

(7) The calculation in (3) must not include:

(a) a *retail client* account that did not have an open *restricted speculative investment* connected to it within the calculation period;

(b) any profits or losses from *investments* other than *restricted speculative investments*;

(c) any deposits of funds; or

(d) any withdrawals of funds.

(8) The *firm* must retain records of the *retail client* accounts used for these calculations for five years.

(9) Where the *retail client* has not approached the *firm* through a website or mobile application, the risk warning must be provided in a *durable medium* in good time before the *firm* carries on any business for the *retail client*.

(10) Where the communication, information or *financial promotion* referred to in *COBS* 22.5.6R(1) is in a medium other than a *durable medium*, website or webpage, the following risk warning must be included:

[**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."

(11) For the purposes of *COBS* 22.5.6R(10), if the number of characters contained in that risk warning exceeds the character limit permitted by a third party marketing provider, the following risk warning must be used:

[insert percentage per provider]% of retail CFD accounts lose money."

(12) Where the risk warning in *COBS* 22.5.6R(11) is used, the *firm* must ensure that the risk warning is accompanied by a direct link to the *firm's* webpage which contains the risk warning in *COBS* 22.5.6R.

22.5.7 R (1) If, when required to perform the calculation of percentage of loss, a *firm* has not entered into a single trade involving a *restricted speculative investment* with a *retail client* in the previous 12 *months*, the *firm* must use the following risk warnings as appropriate for the purposes of *COBS* 22.5.6R:

(a) where the communication, information or *financial promotion* is provided in a *durable medium*, website or webpage:

"CFDs are complex instruments and come with a high risk of losing money rapidly due to leverage. **The vast majority of retail client accounts lose money when trading in CFDs.** You should consider whether you can afford to take the high risk of losing your money."

(b) where the communication, information or *financial promotion* is in a medium other than a *durable medium*, website or webpage:

"The vast majority of retail client accounts lose money when trading in CFDs. You should consider whether you can afford to take the high risk of losing your money."

(c) For the purposes of *COBS* 22.5.7R(1)(b), where the number of characters contained in that risk warning exceeds the character limit permitted by a third party marketing provider, the following risk warning must be used:

"CFD-retail client accounts generally lose money."

22.5.8 R The relevant risk warning in *COBS* 22.5.6R or *COBS* 22.5.7R must be:

(1) prominent;

(2) contained within its own border and with bold and unbold text as indicated;

(3) if provided on a website or via a mobile application, statically fixed and visible at the top of the screen even when the *retail client* scrolls up or down the webpage; and

(4) if provided on a website, included on each linked webpage on the website.

22.5.9 G The relevant risk warning, including the font size, should be:

(1) proportionate, taking into account the content, size and orientation of the marketing material as a whole; and

(2) published against a neutral background.

Margin requirements for retail clients

22.5.10 R A *firm* must not open a position in relation to a *restricted speculative investment* for a *retail client* unless the *margin* posted to open the position is in the form of *money*.

22.5.11 R A *firm* must require a *retail client* to post *margin* to open a position of at least the following amounts:

(1) 3.33% of the value of the exposure that the trade provides when the underlying asset is a *major foreign exchange pair* or *relevant sovereign debt*;

(2) 5% of the value of the exposure that the trade provides when the underlying asset is a *major stock market index*, *minor foreign exchange pair* or gold;

(3) 10% of the value of the exposure that the trade provides when the underlying asset is a *minor stock market index* or a *commodity* other than gold;

(4) 50% of the value of the exposure that the trade provides when the underlying asset is a cryptocurrency; or

(5) 20% of the value of the exposure that the trade provides when the underlying asset is a *share* or an asset not otherwise listed in *COBS* 22.5.11R(1) to (4) above.

22.5.12 G For the purposes of *COBS* 22.5.11R, "exposure" means the total value of the exposure that the *restricted speculative investment* provides. An

example is set out below.

(1) A *firm* offers a *restricted speculative investment* when the underlying asset is a 5 x leveraged index on gold. The value of the index is £800. The value of the exposure that the trade provides is therefore £800 x 5, or £4000.

Margin close out requirements for retail clients

22.5.13 R (1) A *firm* must ensure a *retail client's* net equity in an account used to trade *restricted speculative investments* does not fall below 50% of the *margin* requirement (as outlined in *COBS* 22.5.11R) required to maintain the *retail client's* open positions.

(2) Where a *retail client's* net equity falls below 50% of the *margin* requirement, the *firm* must close the *retail client's* open position(s) on restricted speculative investments as soon as market conditions allow.

(3) In this *rule*, "net equity" means the sum of the *retail client's* net profit and loss on their open position(s) and the *retail client's* deposited *margin*.

22.5.14 R A *firm* must not maintain an open position in relation to a *restricted speculative investment* for a *retail client* unless the *margin* posted to maintain the open position is in the form of *money*.

22.5.15 R A *firm* must provide to a *retail client* a clear description in a *durable medium* or make available on a website (where that does not constitute a *durable medium*) that meets the *website conditions* of how the *retail client's margin* close out level will be calculated and triggered:

(1) in good time before the *retail client* opens their first position; and

(2) in good time before any change to the terms and conditions applicable to the *retail client* takes effect.

22.5.16 G *Firms* are reminded that they must comply with *COBS* 2.1.1R (the client's best interests rule) and *COBS* 11.2A.2R (obligation to execute orders on terms most favourable to the client) when:

(1) making a *margin* call to a *retail client*; or

(2) exercising a discretionary right to close a *retail client's* position; or

(3) closing a *retail client's* position(s).

Negative balance protection

22.5.17 R The liability of a *retail client* for all *restricted speculative investments* connected to the *retail client's* account is limited to the funds in that account.

22.5.18 G *COBS* 22.5.17R means that a *retail client* cannot lose more than the funds specifically dedicated to trading *restricted speculative investments*.

22.5.19 G For the purposes of *COBS* 22.5.17R, funds in a *retail client's* account are limited to the *cash* in the account and unrealised net profits from open positions. "Unrealised net profits from open positions" means the sum of unrealised gains and losses of all open positions recorded in the account. Any funds or other assets in the *retail client's* account for purposes other than trading *restricted speculative investments* should be disregarded.

Restrictions on monetary incentives and non-monetary incentives

22.5.20 R A *firm* must not offer to a *retail client*, or provide a *retail client* with, any of the following when marketing, distributing or selling a *restricted speculative investment*:

(1) a monetary incentive; or

(2) a non-monetary incentive.

22.5.21 G For the purposes of *COBS* 22.5.20R:

(1) monetary incentives include, but are not limited to, the offering of bonuses in relation to the opening of a new account or the offering of rebates on fees (including volume-based rebates);

(2) lower fees offered to all *retail clients* do not constitute a monetary incentive; and

(3) information and research tools do not constitute non-monetary incentives.

Other products

22.5.22 G *Firms* that market, distribute or sell *derivatives* with similar features to *restricted speculative investments* (particularly where the *derivatives* are leveraged) to *retail clients*, should have particular regard to how they comply with applicable obligations found elsewhere in the *FCA Handbook*, including, where relevant:

(1) *COBS* 2.1.1R (The client's best interests rule);

(2) *COBS* 4.2.1R (The fair, clear and not misleading rule);

(3) *COBS* 9A (Suitability (MiFID and insurance-based investment products provisions));

(4) *COBS* 10A (Appropriateness (for non-advised services) (MiFID and insurance-based investment products provisions));

(5) *PRIN*, particularly *principles* 1, 2 and 6; and

(6) *PROD* 3 (Product governance: MiFID).

Part 2: Comes into force on 1 September 2019

Amend the following as shown.

22.5 Restrictions on the retail marketing, distribution and sale of contracts for differences and similar speculative investments

…

22.5.1 R (1) Subject to (2), *COBS* 22.5.1AR, *COBS* 22.5.1BG and *COBS* 22.5.1CR this section applies to:

…

22.5.1A R The *rules* in this section do not apply to the sale and distribution of *restricted options* by a *firm* (F) in circumstances where F sells a *restricted option* to a *retail client* through an intermediary.

22.5.1B G For the avoidance of doubt, the exclusion in *COBS* 22.5.1AR only applies to F.

22.5.1C R The *rules* in this section do not apply to the sale and distribution of *restricted options* by an *EEA MiFID investment firm* (EEAMIF) in circumstances where:

(1) the EEAMIF has not marketed, nor caused to be marketed, the *restricted option* in the *United Kingdom*; and

(2) the *retail client* is in the *United Kingdom* and has approached the EEAMIF at their own exclusive initiative.

…

Standardised risk warning

22.5.6 R (1) Subject to *COBS* 22.5.7R and *COBS* 22.5.7AR, a *firm* must not:

(a) …

(b) …

(c) …

unless the *firm* includes one of the following risk ~~warning:~~ warnings, as appropriate.

> ~~"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."~~

(1A) Subject to 1B, if a *firm* markets, distributes or sells:

(a) leveraged *contracts for differences*;

(b) leveraged *spread bets*; or

(c) leveraged *rolling spot forex contracts*,

the *firm* must include the following 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."

(1B) If a *firm* markets, distributes or sells:

(a) *restricted* options; and

(b) one or more of the following:

(i) leveraged *contracts for differences*;

(ii) leveraged *spread bets*; or

(iii) leveraged *rolling spot forex contracts*,

the *firm* must include the following risk warning:

> "CFDs and restricted options 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 and restricted options with this provider.**
>
> You should consider whether you understand how CFDs and restricted options work and whether you can afford to take the high

risk of losing your money."

(1C) If a *firm* markets, distributes or sells *restricted options* but does not market, distribute or sell leveraged *contracts for differences*, leveraged *spread bets* or leveraged *rolling spot forex contracts*, the *firm* must include the following risk warning:

> "Restricted options 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 restricted options with this provider.**
>
> You should consider whether you understand how restricted options work and whether you can afford to take the high risk of losing your money."

…

(10) Where the communication, information or *financial promotion* referred to in *COBS* 22.5.6R(1) is in a medium other than a *durable medium*, website or webpage, *firms* must include one of the following risk ~~warning~~ warnings, ~~must be included:~~ as appropriate.

> ~~**[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."~~

(10A) Subject to 10B, if a *firm* markets, distributes or sells:

(a) leveraged *contracts for differences*;

(b) leveraged *spread bets*; or

(c) leveraged *rolling spot forex contracts*,

the *firm* must include the following 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."

(10B) If a *firm* markets, distributes or sells:

(a) *restricted* options; and

(b) one or more of the following:

(i) leveraged *contracts for difference*;

(ii) leveraged *spread bets*; or

(iii) leveraged *rolling spot forex contracts*,

the *firm* must include the following risk warning:

> **“[insert percentage per provider]% of retail investor accounts lose money when trading CFDs and restricted options with this provider.**
>
> You should consider whether you can afford to take the high risk of losing your money.”

(10C) If a *firm* markets, distributes or sells *restricted options* but does not market, distribute or sell leveraged *contracts for differences*, leveraged *spread bets* or leveraged *rolling spot forex contracts*, the *firm* must include the following risk warning:

> **“[insert percentage per provider]% of retail investor accounts lose money when trading restricted options with this provider.**
>
> You should consider whether you can afford to take the high risk of losing your money.”

…

22.5.7 R (1) This rule applies when: ~~If, when required to perform the calculation of percentage of loss, a *firm* has not entered into a single trade involving a *restricted speculative investment* with a *retail client* in the previous 12 *months*, the *firm* must use the following risk warnings as appropriate for the purposes of *COBS* 22.5.6R:~~

(a) ~~where the communication, information or *financial promotion* is provided in a *durable medium*, website or webpage:~~

> ~~“CFDs are complex instruments and come with a high risk of losing money rapidly due to leverage.~~
>
> ~~**The vast majority of retail client accounts lose money when trading in CFDs.**~~
>
> ~~You should consider whether you can afford to take the high risk of losing your money.”~~

a *firm* is required to perform the calculation of percentage of loss for the purposes of the risk warning and the *firm* has not entered into a single trade involving a *restricted speculative investment* with a *retail client* in the previous 12 *months*; and

(b) ~~where the communication, information or *financial promotion* is in a medium other than a *durable medium*, website or~~

~~webpage:~~

> ~~**“The vast majority of retail client accounts lose money when trading in CFDs.**~~
>
> ~~You should consider whether you can afford to take the high risk of losing your money.”~~

the *firm’s* communication, information or *financial promotion* is provided in a *durable medium*, website or webpage.

(c) ~~For the purposes of *COBS* 22.5.7R(1)(b), where the number of characters contained in that risk warning exceeds the character limit permitted by a third party marketing provider, the following risk warning must be used:~~ [deleted]

> ~~**“CFD retail client accounts generally lose money.”**~~

(2) The *firm* must use one of the following risk warnings as appropriate for the purposes of *COBS* 22.5.6R:

(a) If a *firm* markets, distributes or sells:

(i) leveraged *contracts for differences*;

(ii) leveraged *spread bets*; or

(iii) leveraged *rolling spot forex contracts*,

the *firm* must use the following risk warning:

> “CFDs are complex instruments and come with a high risk of losing money rapidly due to leverage.
>
> **The vast majority of retail client accounts lose money when trading in CFDs.**
>
> You should consider whether you can afford to take the high risk of losing your money.”

(b) If a *firm* markets, distributes or sells:

(i) *restricted options*; and

(ii) leveraged *contracts for differences*;

(iii) leveraged *spread bets*; or

(iv) leveraged *rolling spot forex contracts*,

the *firm* must use the following risk warning:

> “CFDs and restricted options are complex instruments and

> come with a high risk of losing money rapidly due to leverage.
>
> **The vast majority of retail client accounts lose money when trading in CFDs and restricted options.**
>
> You should consider whether you can afford to take the high risk of losing your money."

(c) If a *firm* markets, distributes or sells *restricted options* but does not market, distribute or sell leveraged *contracts for differences*, leveraged *spread bets* or leveraged *rolling spot forex contracts*, the *firm* must use the following risk warning:

> "Restricted options are complex instruments and come with a high risk of losing money rapidly due to leverage.
>
> **The vast majority of retail client accounts lose money when trading in restricted options.**
>
> You should consider whether you can afford to take the high risk of losing your money."

22.5.7A R (1) This *rule* applies when:

(a) a *firm* is required to perform the calculation of percentage of loss for the purposes of the risk warning and the *firm* has not entered into a single trade involving a *restricted speculative investment* with a *retail client* in the previous 12 *months*; and

(b) the *firm's* communication, information or *financial promotion* is in a medium other than a *durable medium*, website or webpage.

(2) The *firm* must use one of the following risk warnings as appropriate for the purposes of *COBS* 22.5.6R:

(a) If a *firm* markets, distributes or sells:

(i) leveraged *contracts for differences*;

(ii) leveraged *spread bets*; or

(iii) or leveraged *rolling spot forex contracts*,

the *firm* must use the following risk warning:

> **"The vast majority of retail client accounts lose money when trading in CFDs.**
>
> You should consider whether you can afford to take the high risk of losing your money."

(b) If a *firm* markets, distributes or sells:

(i) *restricted options*; and

(ii) leveraged *contracts for differences*;

(iii) leveraged *spread bets*; or

(iv) leveraged *rolling spot forex contracts*,

the *firm* must use the following risk warning:

"The vast majority of retail client accounts lose money when trading in CFDs and restricted options. You should consider whether you can afford to take the high risk of losing your money."

(c) If a *firm* markets, distributes or sells *restricted options* but does not market, distribute or sell leveraged *contracts for differences*, leveraged *spread bets* or leveraged *rolling spot forex contracts*, the *firm* must use the following risk warning:

"The vast majority of retail client accounts lose money when trading in restricted options. You should consider whether you can afford to take the high risk of losing your money."

(d) Where the number of characters contained in the risk warnings in this *rule* exceeds the character limit permitted by a third party marketing provider, the following risk warning must be used:

"CFD-retail client accounts generally lose money."

…

22.5.12 G For the purposes of *COBS* 22.5.11R, "exposure" means the total value of the exposure that the *restricted speculative investment* provides. ~~An example is~~ Examples are set out below.

(1) A *firm* offers a *restricted speculative investment* when the underlying asset is a 5 x leveraged index on gold. The value of the index is £800. The value of the exposure that the trade provides is therefore £800 x 5, or £4000; or

(2) a *firm* offers a *contract for differences* where the underlying asset is a *restricted option* that references the FTSE 100. For this *contract for differences*, the value of the exposure that the trade provides is equal to the value of the underlying asset of the *restricted option*. For pricing the *restricted option*, the *firm* offers £1 of exposure for each point of the FTSE 100. Under these terms, if the *retail client* buys the *contract for differences* on a *restricted option* when the FTSE 100 is

trading at 7070, the value of the exposure that the trade provides is £7070 (i.e. 7070 x £1).

Pub ref: 006052

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