

## **Warning about CFDs, binary options and other speculative products**

ESMA and a number of national supervisors have observed an increase in the offer of speculative products, including financial contracts for difference (CFDs), binary options and other speculative products (such as rolling spot forex) to retail clients, and at the same time a surge in the numbers of complaints from investors who have suffered significant losses when trading these products.

The proliferation of these types of products gives rise to investor protection concerns. These products are inherently risky, complex and speculative. Supervisors have also observed that they are often marketed and sold in an aggressive way and that some firms fail to comply with their regulatory obligations under MiFID, creating the conditions for retail investors to suffer significant detriment, e.g. in the form of unexpected losses.

These products carry a very high level of risk. They are not standardised and the specific features of the products can be different from one provider to another, including for example in relation to the terms, conditions and costs involved. Studies performed by some national supervisors show that in most cases, retail clients speculating in CFDs, binary options or other speculative products lose the money they have invested.<sup>1</sup> However, notwithstanding these features, in many cases, these products are widely advertised to the retail mass market across the European Union, often via online platforms.

Furthermore, it has been observed that these products are also being offered by unauthorised and unregulated entities which further adds to the risk of investor detriment.

The provision of these types of speculative products to retail clients is a topic that ESMA has been monitoring for some time. ESMA's [investor warning](#) on CFDs<sup>2</sup>, published in February 2013, highlights some of the main risks of investing in CFDs and urges investors to check if their provider is authorised to do investment business in their country. It also describes some poor practices that have been observed in this sector of the market. ESMA observed that potential gains may be advertised in a way that is designed to encourage retail investors to trade and emphasises the possible gains without fully explaining, or giving sufficient

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<sup>1</sup> For example, many of these products require investors to post money to a margin account and this money may be lost if the investment is out-of-the-money by an amount in excess of the money posted to the margin account. The probability of a loss incurred in this way tends to be very high.

<sup>2</sup> <https://www.esma.europa.eu/sites/default/files/library/2015/11/2013-267.pdf>

prominence to the risks involved and the potential for losses. The retail investor might conclude that there is little or no risk involved when investing in speculative products. This is wrong. Providers of CFDs, binary options and other speculative products may also offer “free start-up money”, gifts, discounted fees, or trading tutorials in order to attract retail investors as new clients.

Generally, the buying and selling of these speculative products, especially when done online, is not accompanied by investment advice. This means that an assessment of suitability of the product for clients does not take place. Nevertheless, an authorised and regulated firm must first check that dealing in speculative products is appropriate for the retail investor and that he/she is aware of the risks involved.

In the cases mentioned here, many of the risks for retail clients are caused by the business models adopted by firms in this sector, which may create conflicts between the commercial interests of the firm and the interests of the retail client. For example, if the remuneration of staff or affiliates is linked solely to the numbers of new clients signed up, or if the profit of the firm is directly linked to the loss of the retail client, a clear conflict of interest exists that should be avoided.

In February 2014, ESMA also issued an [opinion](#) on MiFID practices for firms selling complex products and an accompanying [investor warning](#) on the risks of investing in complex products.

ESMA’s recent focus has been on promoting common supervisory approaches and practices across Europe in relation to the provision of CFDs, binary options and other speculative products to retail clients, as this is an area in which many competent authorities have serious concerns about the protection of investors and where there is a considerable degree of cross-border activity.

In April, June and July 2016, ESMA published questions and answers ([Q&As](#)) on the provision of CFDs and other speculative products to retail clients. The purpose of these Q&As is to enhance supervisory convergence in the application of MiFID I and its implementing measures on key topics that are relevant when such speculative products are sold to retail investors.

Since mid-2015, ESMA has been coordinating the activities of a group comprising a number of host National Competent Authorities (NCAs) and the Cyprus Securities and Exchange Commission (CySEC), in its capacity as home NCA<sup>3</sup>. The work of this group has focussed on issues arising in relation to a number of Cyprus-based investment firms offering CFDs, binary

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<sup>3</sup> Under MiFID, the home Member State NCA is responsible for supervising the activities of firms that provide investment services on a cross-border basis without a branch. Nonetheless, the sharing of information and ongoing cooperation between home and host NCAs (i.e. the supervisory authorities in the countries where the customers reside) is an important aspect of the MiFID framework.

options and other speculative products that are operating throughout Europe on a cross-border basis. The group has therefore been operating as a forum for mutual cooperation between the members. In the context of its supervisory action plan, CySEC has so far imposed administrative fines or reached settlement agreements totalling €2,072,000 with a number of investment firms that are active in this sector of the market.<sup>4</sup> In addition, further to the administrative fines imposed by CySEC and the suspension of the license of one firm, this firm has withdrawn its authorisation and has entered into a three-month orderly wind down.<sup>5</sup> CySEC has also issued a number of regulatory circulars to all Cyprus investment firms addressing some of the issues it has identified.<sup>6</sup> CySEC's supervisory and regulatory work is ongoing.

ESMA will continue its monitoring and supervisory convergence work in this area by promoting increased cooperation amongst home and host NCAs in relation to the cross-border operations of firms, including coordinating the ongoing cooperation work of the group of NCAs, and by continuing its ongoing policy work. ESMA will also consider the need for any further work on this topic, in the medium term, in light of new requirements and powers under the MiFID II/MiFIR<sup>7</sup> framework, which will enter into application in January 2018.

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<sup>4</sup> Depaho Ltd (€233,000): <http://www.cysec.gov.cy/CMSPages/GetFile.aspx?guid=5ba06a29-be58-4e02-a24f-dd596d230dae>  
Reliantco Investments Ltd (€123,000): <http://www.cysec.gov.cy/CMSPages/GetFile.aspx?guid=a144fd9f-ed9c-4d41-896f-09fe898941ae>

IronFX Global Ltd (€335,000): <http://www.cysec.gov.cy/CMSPages/GetFile.aspx?guid=f3b8aa80-6679-4efa-9ede-6cb53097e8d5>

WGM Services Ltd (€340,000): <http://www.cysec.gov.cy/CMSPages/GetFile.aspx?guid=b57a74c8-f15a-462e-b75d-c44bd464ade4>

Pegase Capital Ltd (€300,000): <http://www.cysec.gov.cy/CMSPages/GetFile.aspx?guid=089b6e37-c13b-4897-81de-3e829798e03b>

Rodeler Ltd (€156,000): <http://www.cysec.gov.cy/CMSPages/GetFile.aspx?guid=762d983f-f9f2-4041-bcea-22382256f64f>

Banc de Binary Ltd (€350,000): <http://www.cysec.gov.cy/CMSPages/GetFile.aspx?guid=34e2a317-00c6-41c4-9be6-c147f94ba65d>

Ouroboros Derivatives Trading Ltd (€235,000): <http://www.cysec.gov.cy/CMSPages/GetFile.aspx?guid=03ce3ac7-449f-4a2e-969d-cd8e68001585>

<sup>5</sup> Pegase Capital Ltd: <http://www.cysec.gov.cy/CMSPages/GetFile.aspx?guid=1486bd24-fa9f-47a9-8635-2d8ed3e4afdf> and <http://www.cysec.gov.cy/CMSPages/GetFile.aspx?guid=26d23b75-ef81-4bf3-8b62-ee08c1ad0419> and <http://www.cysec.gov.cy/CMSPages/GetFile.aspx?guid=871ed8de-daf3-4611-aaa9-5e1bef20929a> and <http://www.cysec.gov.cy/CMSPages/GetFile.aspx?guid=178807a5-c43c-419f-b345-122cd92662f2>.

<sup>6</sup> CySEC's circulars are available on the CySEC website at: <http://www.cysec.gov.cy/en-GB/public-info/circulars/>. Relevant topics include: trading in binary options; remuneration policies and practices; client complaints-handling; website addresses, domain names and redirecting clients,

<sup>7</sup> Directive 2014/64/EU and Regulation (EU) 600/2014 and their implementing measures.