European Securities and Markets Authority
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Submitted online at www.esma.europa.eu

RE: ESMA's call for evidence on effects of product intervention measures regarding CFDs and binary options on market participants and clients (ESMA35-43-2090)

Dear ESMA,

Saxo Group[1] is pleased to have the opportunity to respond to the call for evidence on effects of product intervention measures regarding CFDs and binary options on market participants and clients.

We strongly support pan-European product intervention measures secures a level playing field to both investors and market participants. This will not only remove the inconsistencies caused by divergent national product intervention measures but also strengthen supervisory convergence in Single Market. Uniform levels of retail investor protection will be established for the European retail investors accordingly.

We welcome the opportunity to comment on the issues raised by this call for evidence and will continue to contribute to the thinking of ESMA on any issues that may assist in the final outcome.

We welcome further discussion on any of the points that we have raised.

Yours sincerely,

Saxo Group

[1] Saxo Group facilitates trading and investing for private and institutional clients, providing access to global markets and a broad range of asset classes and tradable instruments across global financial markets from one single margin account and across multiple devices. Saxo Group's trading platforms are available in more than 20 languages and form the technology backbone of more than 100 financial institutions worldwide.

Responses to questions

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

Based on the QA of ESMA's product intervention measures regarding CFDs, the 'payments for the purpose of entering into a CFD' is limited to cash (ESMA35-36-1262, Q5.2) and 'sum of funds in the CFD trading account' includes cash only (ESMA35-36-1262, Q5.3). However, given the fact that all clients (including retail clients), for maximum capital efficiency, are enjoying the ability to trade a broad range of financial instruments (CFDs as well as other margined and cash products) in single multi-asset accounts offered by Saxo Group, the 'cash-only' set-up on CFD positions may not be in the best interest of these clients. In single multi-asset accounts, the benefits of engaging in a non-cash collateral-based transaction in fact outweighs transactions collateralised by cash:

1. **Asset diversification in single multi-asset accounts**

   Since ESMA's product intervention measures only cover the CFD positions, this is not aligned with the purpose of diversification of investment (which is one of the well-recognised approaches to manage the risk) in single multi-asset accounts.

   Specifically, many clients with Saxo are trading related positions that are part of the same multi-product investment strategy, where hedges work dynamically with the diversification of risk. e.g. hedging beta-exposure arising from a portfolio of stocks with a CFD index. However, the clients could lose the benefit of portfolio diversification because they are closed out of their specific positions relating to wider hedged portfolios as per the implementation of ESMA's product intervention measures on CFDs. We have seen this significantly alters the client's overall exposure and risk.

   Therefore, in order to find a good balance between the investor protection on CFDs and the diversification purpose of investors, the margin close out protection should be offered on an account basis (rather than the position basis).

2. **Asset liquidation in single multi-asset accounts**

   Removing the benefit of using non-cash collateral (e.g. stocks and bonds) from retail clients indeed increases the number of forced liquidations.

   In practice, clients depend upon a collateral buffer in their account to protect them from premature stop-out of individual positions that could materially change the market view expressed in their portfolio. This will undoubtedly occur at times of temporary market stress which will subsequently have a marked negative impact on the wholesale market. It is inconvenient (and not transparent) in situations where the client may find himself unintentionally taking more single directional risk, rather than diversifying his strategy.

   Continuing to provide clients with the dynamic benefit of account collateral is therefore important both to client outcomes and to ensuring the best interface between retail and wholesale markets.

3. **Asset optimisation in single multi-asset accounts**

    Using non-cash collateral indeed offers the ability of the clients to optimise interest on collateral. Specifically, a non-cash collateral-based transaction negates the negative or low interest rate environment globally. By removing this possibility, the client would be forced to get little or no interest on the cash collateral held in the account to maintain open margin positions.

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

No comment.

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

Saxo Group, as a market participant, observes different CFD national product intervention measures confusing the clients and creating a lot of inconsistency in the European Single Market. As already identified by ESMA in early 2017, financial institutions are heavily utilizing the passporting and cross-border provision of services in the EU Single Market (Section 10, ESMA35-36-794). Several issues therefore are arising from this 'uneven' playing field in the post-ESMA period:

1. **Inconsistency of the national product intervention measures**

    Given the fact that ESMA has no binding power in accordance with Article 42 of Regulation (EU) No 600/2014 (MiFIR), national competent authorities (NCAs) are able to choose 'whether' and 'how' they would like to impose national product intervention measures. This results in significant inconsistencies in different Member States (as summarised in Annex I of this Call for Evidence paper).

    In addition, due to the lack of common QA published by ESMA, no supervisory convergence could be found in practice. For example, KNF in Poland is taking another calculation method of the margin close-out protection by interpreting 'total initial margin' in a different way compared to other NCAs. This means Polish retail clients will have a different margin close-out protection, even though the legislative wording is exactly same in some other Member States. Also, FCA in the UK, compared to other NCAs, is very specific in the placement of the risk warning on the website. This leads to inconsistency in application of risk warnings within the European Single Market with regard to prominence and placement used.

    Attributed to the inconsistency caused, there is no levelling investor protection in the European Single Market, and this enhances the possibility of the so-called 'regulatory arbitrage' in the EU.

2. **Complexity added by the host Member State/home Member State/hybrid principle**

   According to Article 42 of MiFIR, NCAs are allowed to impose relevant product intervention measures 'in' and 'from' their Member States. This adds a lot of complexities to both market participants and their clients.

   In particular, some NCAs decided to take the home Member State principle (i.e., their national product intervention measures only cover the firms registered in their jurisdictions), while some NCAs took the host Member State principle (i.e., all firms, regardless they are registered in their jurisdictions or not, should follow their national product intervention measures once they are servicing the clients who are based in their jurisdictions). There is even a hybrid approach in some Member States. In practice, the clients may be protected by more than one national product intervention measures, and those measures are different and even conflicting.

   Furthermore, the host Member State principle may not be applicable if the clients change their residencies to another Member State. The clients then are under the different (lower/higher) protection even though they are keeping the same legal relationships with the same investment firms.

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

No comment.

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

Saxo Group fully support the amendment of the product intervention powers of ESMA. This can remove the inconsistencies caused by divergent national product intervention measures and strengthen supervisory convergence in Single Market. This is indeed necessary to ensure a level playing field to both European investors and market participants.

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

Saxo Group has observed two examples of potential circumvention of the CFD product intervention measures in the market.

1. **Similar products, which are not captured by the specific definition of binary options and CFDs, are being promoted in the market.**

   As clarified by ESMA, turbo certificates are not in scope of the product intervention measures on CFD (Q5.10, ESMA35-36-1262), so some market participants could build products that that specifically do not fit the specific definition, in order to circumvent relevant product intervention measures. Some NCAs

(e.g., FCA) try to cope with this by introducing another definition to include the so-called 'CFD-like' products (e.g., FCA Policy Statement PS19/18). This however falls into another specific definition and opens another out-of-scope room creating potential for some firms look for gaps in the definition.

In fact, to consult ongoingly on the wording of the definition, which is time consuming and costly. A more generic responsibility on the firms to ensure they are working within the intention of the rules could be a better option. As ESMA already defined in early 2017, '*the provision of CFDs and other speculative products to retail investors*' (ESMA 35-36-794) should be a good starting point to reconsider the proper scope/definition of relevant product intervention measures.

2. **The profit/loss percentage required in the risk warning on CFD is not being used properly in the market**

   Saxo Group fully supports the risk warning in ESMA's product intervention measures on CFD. However, we think that using the data of percentage of clients that lose money in isolation is of little value. By comparing the percentage between the brokers who only offer CFD accounts and the brokers who offer single multi-asset accounts, these numbers are confusing and misleading to retail clients. As bad practice, some firms are even using the profit/loss percentage in comparison tables as a marketing tool. In order to prevent the misuse by firms and the misleading caused, we suggest two potential options to improve it:

   First, we suggest that the profit/loss percentage should be supplemented with a standardised enhanced disclosure to engender greater confidence in clients when choosing between different providers. For example, a disclosure could describe the percentage of positions hedged; or percentage of client trades that are either automatically stopped out or stopped out due to the client placing a stop-loss order. This disclosure should be one click away, along the lines of the content on (https://www.home.saxo/about-us/enhanced-disclosure, etc.). This level of commitment may simultaneously help to resist any potential flow of business offshore to potentially unscrupulous providers who are possibly less concerned with promoting fair outcomes to consumers. This speaks to the importance of raising awareness to clients not only of product risks, but also the importance of choosing to deal with a well capitalised firm that acts with minimal conflict of interest with clients.

   Second, as mentioned by ESMA, the likelihood of losses may change over time and continuously monitoring its accuracy may be challenging. Alternatively, by using clearer or plainer sentences 'the vast majority of retail client accounts' or 'retail client accounts generally lose money', the general risk warning should then be good enough to protect retail investors (paras. 9-10 of ESMA35-43-1975).

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

In addition to the comments shared before, Saxo Group believes two relevant topics in the product intervention measures on CFDs should be reviewed:

1. **Unlimited negative balance protection**

   Even the reason for introducing negative balance protection on a per-account basis is quite obvious, unlimited negative balance protection may create moral hazard and encourage risk taking because the client's downside is limited (in particular in the single multi-asset accounts offered by Saxo Group). Furthermore, negative balance protection might end up fueling further conflict of interest between market participants and their clients as the market participants might internalise more of the client flows to offset the potential need to cover negative balances. Unlimited negative balance protection would also entail very high and unclear capital requirements.

   It is therefore important to implement a cap along with the negative balance protection (for example, in line with the MiFID II thresholds for retails clients who may be treated as professionals on request).

2. **Missing leverage of CFDs on cryptocurrencies**

   As observed by ESMA, '*Cryptocurrencies are a relatively immature asset class that pose major risks for investors. …… For CFDs on cryptocurrencies many of these concerns remain present. This is because retail clients typically do not understand the risks involved when speculating on an extremely volatile and relatively immature asset class, which are exacerbated by trading on margin, as it requires clients to react in a very short time period*' (Recital 19 of ESMA Decision (EU) 2018/796). It is natural to include CFDs on cryptocurrencies due to the extremely high volatility of the underlying.

   Based on our knowledge, leveraged CFDs on cryptocurrencies are in high demand among retail clients. It is thus suggested that leverage on cryptocurrency CFDs should be capped at 1:1 to avoid excessive risk taking among retail clients, in order to align with the purpose of investor protection emphasised in relevant consultations from IOSCO (IOSCO/MR/11/2019) and UK FCA (CP19/22).

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