Gruppe Deutsche Börse

Response to ESMA´s Call for Evidence towards

"Effects of product intervention measures regarding CFDs and binary options on market participants and clients"

as of September 2019

Frankfurt am Main, 4. November 2019

Introductory remarks

Deutsche Börse Group (DBG) appreciates the opportunity to contribute to ESMA's Call for Evidence on the "Effects of product intervention measures regarding CFDs and binary options on market participants and clients".

As one of the world's leading exchange organisations and an integrated provider of products and services covering the entire process chain of securities and derivatives trading, DBG organises markets characterised by integrity, transparency and safety. The range of its offerings is constantly broadened by new products in existing and new asset classes, in particular in the area of risk and collateral management – complemented by a growing number of solutions for the off-exchange sector. As such, DBG is highly committed to create trust in financial markets and is supportive of measures that aim to enhance investors' financial market confidence.

We welcome ESMA´s approach to consider the views of market participants in its report to the European Commission about the experiences with the new product intervention powers granted in Art. 40 and 42 of the MiFIR. To further improve the application of the regulatory framework regarding the product intervention powers, we would like to make three remarks for ESMA to consider:

- The specific trading environment (OTC vs regulated markets) of any product should be considered by ESMA and competent authorities when considering intervention measures.
- ESMA and competent authorities should follow an evidenced based approach when deciding on any product intervention measure and analyse whether the product itself, the trading style and/ or environment or the market practices cause any concern for financial stability or investor protection.
- If a regulatory intervention measure seems necessary, the scope of any such measures has to be clearly defined to prevent uncertainty and unintended consequences regarding the product scope offered for investors on regulated markets.

In general, as the prohibition or restriction, even on a temporarily basis, of the marketing, distribution or sale of certain financial instruments can have significant adverse effects on the trading volume of the respective instrument, DBG argues that the product intervention powers of ESMA and competent authorities pursuant to Art. 40 and 42 MiFID II should only be used as ultima ratio, if other correcting measures fail.

Detailed Response to the Survey:

<u>Question G: "Are there any suggestions or comments you wish to share to improve the application of the regulatory framework regarding the product intervention powers?"</u>

DBG acknowledges the importance of product intervention powers in order to secure financial stability and investor protection in circumstances defined in Art. 40 MiFID II.

The prohibition or restriction, even on a temporarily basis, of the marketing, distribution or sale of certain financial instruments can have significant adverse effects on the trading volume, and ultimately liquidity, of the respective instrument, which is specifically detrimental in risk transfer markets, like derivatives markets. Therefore, DBG argues that the product intervention powers of ESMA and competent authorities pursuant to Art. 40 and 42 MiFID II should only be used as ultima ratio, if other correcting measures fail.

Due to the potentially detrimental effects of product interventions, competent authorities should carefully impose or extend these measures to not impair the development of products that successfully satisfy the needs of investors. For this reason, every dimension along which products, even of the same product class, can differ should be taken into account in order to prevent subjecting harmless products to the product intervention measures.

DBG holds the view that a purely product-related classification approach is not sufficient to rule out unintended consequences (e.g. such as for example uncertainty in the market or different handling by issuers), to otherwise safe and beneficial products. It would be rather beneficial to consider the respective trading environment, i.e. if a product is traded OTC or at regulated markets. The response focuses on observations made in the space of markets operating derivatives contracts, like exchange traded derivatives, and securitized derivatives, like certificates and warrants.

Products that are traded on regulated markets are embedded in a resilient framework, composed of high regulatory, functional and technical standards. Regulated markets under MiFID II / MiFIR offer a non-discriminatory, multilateral trading environment for exchange traded products. Transparent order books and continuous trading ensure a transparent and orderly formation of prices. Exchange traded products, and specifically for derivatives contracts, are standardized contracts that fulfil the needs of the markets as well as the regulatory requirements for the admission of products and address all the high investor protection standards relevant for exchange trading. This framework ensures that investors are protected and can execute their orders and manage their risks in a transparent, fair, orderly and efficient manner.

This does not hold true for OTC markets where products are less standardized, a high degree of information asymmetry prevails, investors are less protected, and prices often do not form in a fully transparent manner. As a result, ESMA and other regulators have often described the lack of investor protection in the OTC space, which is reflected in the investor protection concerns expressed in ESMA's Decision (EU) 2018/796. By no means have regulated markets been mentioned, neither the products they offer.

To our understanding, a product intervention could limit the potential to improve a product or market and the opportunity for investors to find a more transparent and adequate product. Improved products and respective markets can differ in various ways, and we are proposing to ESMA and competent authorities to not include a product in scope, when alongside product and transparency improvements also adjacent features are prevailing. This could be for example product features that are changed so that the product is sufficiently standardized to be traded on exchange and therefore traded in a transparent way with clear rules, trading environments which are fulfilling regulatory requirements, like under MiFIR and MiFID II for regulated markets, clearing by a CCP under the rules of EMIR, especially for derivatives contracts, or a coherent interplay of central infrastructures (trading venues and or CCPs) and wholesale (sell side) market participants that serve investors (professional or retail) according to their investment needs and adhering to risk management on each level across the trading chain.

Against this background, DBG holds the view that any exchange traded product does not pose significant investor protection concerns, also not to retail investors. Hence, regulators should treat products on regulated markets differently compared to OTC traded products when they impose product intervention measures based on significant investor protection concerns. If no precise distinction between the trading venues is made, legal uncertainties can impair the development of innovative exchange traded products.

For DBG, this would constitute a contradiction with the G20 goals to enhance trading and clearing in a regulated environment. For exchange traded derivatives, for example, a product intervention that includes products that have been further developed to fit exchange traded products frameworks and markets, would impair this objective. This unintended consequence would basically limit the potential of 'futurization' in derivatives contracts, and the G20 goals, where a previously OTC traded derivatives instrument is amended to be coherent with the highest regulatory and exchange traded derivatives standards. Such an impairment in market development could be observed with the question relating on FX rolling spot products, for example, where FX rolling spot futures could potentially be understood to fall under the product intervention scope in the ESMA Q&A, which we strongly oppose and urge ESMA to clarify in line of the argumentation provided. The result has been investor uncertainty and confusion on wholesale market participant level that limited the potential of 'futurization' and achieving the G20 goals, to offer an improved product and market to investors. The contrary is the effect, market participants remain OTC, an environment they are more familiar with, despite the known insufficiencies.

To resolve these inconsistencies, DBG would welcome if ESMA and competent authorities acknowledge the high investor protection safeguards of regulated markets and add the trading venue of a product as a distinctive product feature to the purely product-related classification approach when deciding on any regulatory intervention.

To determine whether a specific regulatory intervention measure should be considered, DBG argues that ESMA and the competent authorities should follow an evidenced based approach, to analyse whether the product itself, the trading style and/or environment or the market practices cause the malfunctioning. This could also help determining the potential intended and unintended effects of such a measure.

If, however, ESMA or the competent authorities would come to the conclusion that a regulatory intervention measure is necessary, we think it is very important that the scope of any such measures is clearly defined, as any unclarity could have negative effects.

Stemming from lessons of a similar market, for example, the question, whether securitized derivatives (inline warrants, stay high/stay low warrants) would be subject to the product intervention measures regarding binary options has been open over weeks in the past.

This has caused uncertainty in the market and different handling by issuers due to different legal opinions in the past. Some issuers stopped issuance of new products thus causing also uncertainty for retail investors and consequently decline of turnover on stock exchanges.

Consequently, a product type which has been successfully traded on stock exchanges for decades was negatively impacted incidentally.

Furthermore, confusing market participants on the wholesale side and forcing them to stay OTC and further harming retail investors, as they remain in the OTC space with inferior environments without features of robust trading and clearing environments. Some investors rather are willing to be categorized under 'professional' or experienced clients and remain in CFD/ OTC markets, than supporting the G20 rules and move to more transparent venues, as there is no motivation to do so if all products are accounted for in the same way.

Therefore, it would be desirable, in case of unclarity, that financial instruments, which are not within the scope of any measures, would be explicitly addressed.

We would welcome if our comments are understood in the general aim of improving the functioning of the framework and remain at the disposal of ESMA for any questions and additional feedback.