



Warsaw, 4 November 2019

## IDM response to ESMA interrogations – ESMA product intervention measures

### About IDM

The Polish Chamber of Brokerage Houses ("IDM") welcomes the opportunity to respond to ESMA's interrogations – ESMA product intervention measures.

IDM is self-government organization of investment firms, established in 1996. Membership in the IDM is voluntary and open for all investment firms operating in the Republic of Poland. IDM represents and protects common interests of its members, with respect to legal regulations related to capital market. Our objective is to develop and issue opinions and positions in matters determining the correct operation of the Polish capital market. Currently the Chamber represents 21 investment firms.

Further to the publication of the new product intervention measures, regulating the provision of CFDs and binary options to retail investors, issued by the European Securities and Markets Authority (ESMA), please find the response of the Polish Chamber of Brokerage Houses (IDM), the association of brokerage houses and offices in Poland to the ESMA's consultations: „EFFECTS OF PRODUCT INTERVENTION MEASURES REGARDING CFDs AND BINARY OPTIONS ON MARKET PARTICIPANTS AND CLIENTS”.

The Polish brokerage industry is critical of the legal changes introduced by ESMA. **ESMA measures do not address real challenges or needs of individual investors in the CFD market and therefore do not directly contribute to the increase in the clients' investment security or protection.** The new regulatory restrictions may adversely affect the competitiveness of the European brokerage houses and – as a result – bring the development of the European forex industry to a halt. Moreover, IDM in Poland noticed – following the first months of intervention, increasing client migration to ex EU brokers. It may increase client risk as trading with ex-EU brokers does not cover for EU client protection regulations. Polish client who, due to new constraints, move their investments to other jurisdiction, may lose client protection applicable in Polish legal environment.

ESMA, when adopting its product intervention measures, failed to take into account the opinions and expectations of a large group of active CFD market investors. The results of a survey run by [www.replaytoesma.trading](http://www.replaytoesma.trading) on a sample of 14 600 entities, indicated that 98% of the respondents were against the ESMA regulation. It is also observed that foreign brokers, following ESMA intervention, do have increased trading volumes and revenues due to new client inflow.

Sincerely yours,

Piotr Sobków  
Board Member

The Polish Chamber of Brokerage Houses

***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?***

As a response to question A, the following significant effects should be indicated, as they had an impact on Polish investment companies – participants of the market:

**1. Migration of clients to ex EU brokers that have not been restricted by ESMA regulations. Non-EU companies offer clients from Poland and the European Union the opportunity to trade with higher leverage.**

IDM notices that after the introduction of ESMA's intervention, Polish clients were "flooded" with offers from Swiss and Australian brokers, which led to aggressive selling. Foreign companies encouraged clients to use their services because thanks to them they are able to trade with higher leverage. The Polish Chamber of Brokerage Houses has reported many cases of such activities to the Polish Financial Supervision Authority, indicating risks related to client protection and the risk of lack of competitiveness of the Polish market.

The risk of migration of clients to entities from ex EU countries should be considered as the most significant negative effect of the intervention that has been identified by national supervisors and by ESMA. This problem has been identified by the Polish Financial Supervision Authority and other national supervisory authorities, e.g. the French supervisor, which issued a message indicating how underestimated the risk of clients escaping to ex EU brokers was.<sup>1</sup> According to the Polish Financial Supervision Authority, "this risk materialized, and the factors indicated by ESMA to mitigate the risk of migration were not sufficient".<sup>2</sup>

Six months after the introduction of ESMA intervention, the Polish Chamber of Brokerage Houses researched the effects of intervention. The Polish Financial Supervision Authority (KNF) has also carried out similar studies.

Research shows that every second active and experienced investor has transferred his brokerage account to ex EU brokers who offer better trading conditions, including higher leverage. The reason for moving the brokerage account to countries not covered by ESMA's product intervention, for 99.6% of investors was the possibility of using higher financial leverage. Among the reasons for deciding to change brokers there was the possibility of obtaining the status of a professional client in this country, and thus the possibility of using a higher leverage. Due to the national interpretation of the value of the transaction, obtaining the status of a professional customer in Poland is more difficult than in other EU countries. Domestic brokers, unlike foreign ones, are obliged to treat the value of the margin as the value of the transaction. Investors participating in the survey declared that leverage is one of the key parameters of attractiveness of the forex market. For 66 percent of respondents, the most desirable leverage level for the most popular CFDs is 100: 1.

A survey conducted among retail investors on the Forex / CFD market by the Financial Supervision Authority in Poland indicates that 54% of respondents declared that they opened an account with a broker registered outside the European Union as a result of introducing ESMA's product intervention. 95% of investors from the above group indicated that their decision was influenced by the possibility of using higher financial leverage. Among the remaining respondents, 56% indicated that they are considering undertaking such action. For over 86% of clients, the level of leverage is a very important element taken into account when choosing a broker. The same percentage of respondents indicated that they prefer a leverage level of at least 100: 1.

Irrespective of the above, the Polish supervisory authority confirmed on the basis of confidential data, that the decrease in the activity of Polish clients of Polish CFD providers remains associated with the increase in the number of Polish clients of companies based outside the European Union."<sup>3</sup> In the opinion of the supervisory authority, the appropriate measure that will limit the phenomenon of migration of retail clients to brokers from ex EU countries, which should be associated with a reduction in the level of acceptable leverage resulting from ESMA's intervention, is the introduction of higher leverage for specific CFDs and for a clearly defined group of retail clients.

**2. Client migration to ex EU brokers means a loss of legal protection under EU jurisdiction.**

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<sup>1</sup> <https://www.financemagnates.com/forex/brokers/esmas-worst-nightmare-is-coming-true-clients-move-offshore/>

<sup>2</sup> P. 36. Domestic product intervention. „DECISION NR DAS.456.2.2019 Financial Supervision Authority from 1 August 2019 of the limits in turnover, distribution and selling of CFDs

<sup>3</sup> P. 36. Domestic product intervention. „DECISION NR DAS.456.2.2019 Financial Supervision Authority from 1 August 2019 of the limits in turnover, distribution and selling of CFDs



As a result, client migration to non-EU brokers reduces the investment security of European retail clients as a result of the loss of legal protection appertained by clients within EU jurisdiction.

### **3. Increase in the number of professional clients in some EU countries.**

The negative result of the introduced intervention was the intensification of the reclassification of retail clients into professional clients. Active marketing campaigns of brokers from Cyprus and Great Britain have led to a significant increase in the number of clients treated as professional clients.

There is no accurate data on growth, but the financial reports of investment firms present on regulated markets show that for some of them the number of increased several times. In some investment companies, they already generate 40% of total revenues. Foreign brokers forecast a further increase in the share of professional clients to 50%. According to the report of the largest British CFD broker, 69 percent of the revenues from regions covered by the intervention come from professional clients.

According to the information published in trade portals, some European brokers (Cyprus, United Kingdom) have in their population even about 7 percent of clients reclassified to the professional client. Client reclassification is associated with an increase in investment risk as a consequence of the loss of protection afforded to a retail client. In Poland, this number has not increased and by KNF data in domestic offices and brokerage houses only 1.13 of percent are retail clients<sup>4</sup>.

### **4. Loss of market by European CFD providers**

Data from domestic brokers confirm the collapse in the CFD market. During the first six months of intervention, the number of active clients in domestic brokerage houses dropped by 20% on average. Besides, members of the Chamber of Brokerage Houses report that as a result of the maximum leverage limits introduced, turnover decreased by an average of 50%.

The data collected by the Polish Financial Supervision Authority confirms the Brokerage Houses Chamber's research and additionally indicates a decrease in the activity of retail clients after the introduction of ESMA intervention.

Based on data of the Polish Financial Supervision Authority:

- 55.45% of retail clients of Polish suppliers of difference contracts active during the 12 months before May 31, 2018, in the period from August 1, 2018, to December 31, 2018, did not make any transaction in the field of contracts for difference;
- the number of opening transactions made by retail clients (active during the 12 months before May 31, 2018) in the period from August 1, 2018 to December 31, 2018 decreased by an average of 27.19% compared to the number of transactions carried out in the same period of 2017, with the largest two suppliers dropping 33% and 49.38% respectively "

In the opinion of the Polish Financial Supervision Authority, the reason for the decrease in the number of active investors, decrease in the volume of transactions and decrease in the number of transactions referred to above is too low level of the leverage for some types of contracts for difference based on ESMA product intervention, which results from the answers to the questions contained in two surveys described above.

According to the materials of the Polish Financial Supervision Authority, after the intervention, the entire market has dwindled as a result of a decrease in the number of active accounts of a retail client, and also a significant decrease in the volume of transactions of retail clients as well as a decrease in the number of transactions concluded by these clients.

Simultaneously, the increase in turnover and in the number of active investors is recorded by companies from Switzerland and Australia - countries not covered by ESMA's product intervention. According to the "Intelligence Report Q3 2018" regularly issued by the Finance Magnates portal, Australian companies - IC Markets and Pepperstone - with a general downward trend in turnover volume, recorded an increase or only a slight decrease in this area. Turnover at IC Markets increased in the third quarter of this year. to the level of USD 428 billion per month - a level never recorded in the history of the company - which puts this entity at the forefront of global brokers. The growth of active clients is significant, not only for Australian but also for Swiss

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<sup>4</sup> [https://www.knf.gov.pl/knf/pl/komponenty/img/Komunikat\\_UKNF\\_nt\\_wynikow\\_klientow\\_na\\_rynku\\_Forex\\_2019\\_65254.pdf](https://www.knf.gov.pl/knf/pl/komponenty/img/Komunikat_UKNF_nt_wynikow_klientow_na_rynku_Forex_2019_65254.pdf)

brokers. These companies have gained at least several thousand active investors, while for brokers from the EU a decrease in the number of active traders is visible.

#### 5. ESMA's intervention, contrary to the regulator's expectations, did not reduce the number of automatic stop - out orders (Margin Close Out - MCO) below 5%.

In the model based on ESMA (ESMA intervention parameters and leverage reduction were calculated on its basis), the reduction of the probability of stop - out (MCO) to 5% was considered as an important argument.

However, the analysis by the Polish Chamber of Brokerage Houses shows that the assumption is not appropriate for markets where the maximum leverage was previously regulated. This assumption does not take into account in any way the specifics of the distribution of this parameter on markets where a maximum limitation of the maximum level of leverage has been introduced.

In Poland, there has been a statutory limitation on the leverage level to 100: 1 since 2015. As a result, this condition was met even before the introduction of ESMA product intervention.

To prove, the actual data from the transaction system of one of the members of the Brokerage Houses Chamber is presented in Table 1. These data show, similarly to the ESMA model, the distribution on the basis of statistically **non-modeled but authentically realized transaction closes - stop-out orders**, which are actual automatic closing of transactions in a given group of financial instruments.

Table 1

Calculations throughout history. Value (Before ESMA% / After ESMA%)							
		The number of days to hold a position. % means the percentage of transactions actually closed					
Group of symbols	Average data	0	1	2	3	4	5
Main indexes	2.7% / 1.0%	0.8% / 0.1%	2.2% / 0.5%	4.6% / 2.8%	3.9% / 1.5%	5.9% / 1.5%	6.0% / 5.4%
Major currency pairs	3.0% / 0.4%	1.1% / 0.0%	3.1% / 0.0%	7.0% / 0.3%	5.1% / 0.2%	7.4% / 0.7%	8.6% / 1.2%
Other assets	2.4% / 0.0%	0.8% / 0.0%	2.2% / 0.0%	3.4% / 0.0%	3.0% / 0.0%	3.2% / 0.0%	3.9% / 0.0%
Other indexes	4.2% / 0.4%	1.2% / 0.1%	3.3% / 0.3%	5.2% / 0.2%	4.6% / 0.2%	6.3% / 0.6%	6.5% / 0.3%
Other currency pairs	5.1% / 1.5%	2.3% / 0.6%	4.5% / 1.2%	7.1% / 2.4%	5.7% / 1.6%	7.1% / 3.5%	7.4% / 1.9%
Goods (Rother than gold)	4.2% / 1.9%	1.7% / 0.2%	3.5% / 0.5%	6.6% / 1.0%	5.2% / 0.4%	6.8% / 1.8%	7.4% / 1.7%
Gold	2.1% / 0.1%	0.3% / 0.0%	1.0% / 0.0%	3.5% / 0.3%	2.1% / 0.0%	2.1% / 0.0%	3.7% / 0.0%

The basic assumption of ESMA Intervention is to reduce the probability of stop - out (MCO) to 5%. CySEC referred to this assumption during consultations on CFD and ESMA also bases on them. In justification of the introduction of the product intervention, ESMA presented a projection of the level of leverage for individual categories of instruments for a given transaction duration (1-5 days) so that the probability of MCO occurrence is 5% (approximately). Meanwhile, the analysis of data from an authentic transaction system indicates that in the case of Polish clients, the distribution of such results before the introduction of ESMA product intervention did not exceed the limit of 5%. (the exception is the CFD group of instruments defined as other currency pairs, where the percentage was 5.1 %). In the case of major currency pairs, it did not exceed the average level of 3%. After the ESMA product intervention entered into force, the percentage of transactions closed within five days fell to below 2%. and in the case of major currency pairs and major indices, it does not exceed 1%. It can, therefore, be said that the leverage restrictions introduced by ESMA's intervention are too restrictive and oversized for Polish clients. In the case of this client population, the objectives set by ESMA were met even before the implementation of ESMA's regulations. Therefore, even if ESMA interventions end and the leverage reaches 100: 1, the distribution of client results will be within the framework of the ESMA model.



***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?***

The Chamber of Brokerage Houses did not record binary options related effects of the intervention. This results from the fact that Polish brokers did not offer products classified as binary options.

***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?***

In the opinion of the members of the Chamber of Brokerage Houses, the regulations introduced by ESMA's product intervention did not meet the needs of domestic markets and were excessive concerning the identified needs of investors. Excessively restrictive leverage was disproportionate to the leverage found on other core markets, including futures.

We therefore believe that it is reasonable to introduce regulations that amend ESMA's temporary intervention in a way to adapt ESMA's intervention parameters to national realities. In the case of the Polish market, the Polish Financial Supervision Authority (KNF) showed understanding of the needs and interests of customers, expressed in many surveys, that they are against such a drastic leverage restrictions, which results in regulatory arbitrage. The Polish supervisor partly addressed this problem by introducing the category of Experienced Client, i.e. the liberalization of leverage for the most experienced and market understanding people. Our assessment of the regulations introduced by ESMA is still negative - the form of introduction, the lack of consideration of market participants' opinions during consultations and the lack of consideration of clients' postulates regarding leverage does not allow for a positive assessment of the introduced changes.

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

It should be indicated that the temporary character of the intervention, which was initially introduced for 3 months, according to the members of the Brokerage Houses Chamber, confuses the operating activities of brokers. For a period of 3 months, brokers must change and adapt transaction systems and lead an effective execution of transactions according to the changed rules. For this period, they must adapt transaction systems, risk systems, documentation and other activities important from a technical and operational point of view. These activities cause disturbances in the activities of brokers and may cause problems in their efficient operation.

Another important factor is the impact of temporarily introduced regulations on the brokers' planned activities. They have long-term plans and budgets, which regulations require them to apply. Deviations from these plans affect the assessment of financial companies by supervisors

In our opinion, the temporarily introduced changes do not have the expected effects in terms of improving investment security and the security of retail clients' funds. Their introduction without adequate *vacatio legis* often causes considerable perturbations and problems in broker's operating activities and affects their financial results and long-term business plans.

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

The Brokerage Houses Chamber has repeatedly pointed out that there are entities on the market that do not comply with ESMA's regulations. The Brokerage Houses Chamber informed the Ministry of Finance and the Polish Financial Supervision Authority about such cases by letters of 14 June, 31 July, 29 August, 20 September and 15 November this year. These entities do not comply with EU regulations, including ESMA's interventions and their actions are probably incompatible with national law. Such companies, through intensified Internet advertising campaigns, offer competitive transaction conditions on the OTC market to the European retail clients, encouraging them to use their service and transfer their account there.

As an example, two cases can be given: before the introduction of ESMA intervention. One of the Swiss company conducted an active marketing campaign offering competitive transaction conditions on the OTC market to European retail clients, encouraging them to take use their offer and transfer their account there. In this case, the Polish Chamber of Brokerage Houses sent a letter to the KNF on June 14, 2018.

January 22 this year the Chamber of Brokerage Houses informed the Polish Financial Supervision Authority that the information about investments in the OTC market provided by another company may mislead retail clients and be inconsistent with ESMA's product intervention regulations. On the broker's website, there were no changes aimed at adapting to the regulations introduced on the EU market by ESMA, including no risk warnings. On their website, there was information about "Conditional Leverage". However, the broker did not specify what this provision meant. According to the content of art. 44 paragraph 2 e) of Regulation 2017/565, information on available leverage levels should be specified and clearly indicate that leverage at 1: 400 is available to clients who open an account in the ASIC jurisdiction.

***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 particular, the Chamber indicates that the assumptions for the introduction of ESMA intervention (recital 91 of ESMA Decision 2018/796) based on input data that were out of date and not used for a long time on the CFD market in the EU and Poland.

During the introduction of product intervention on the market, ESMA did not take into account the specificity of the target market/ markets and did not base on current data. The reason for introducing the intervention based on research results assuming the use of very high leverage (400: 1). Meanwhile, in Poland and other European countries restrictions have been introduced in the level of leverage used. In Poland, the maximum leverage limit of 100: 1 has been in force for 4 years. In the opinion of Chamber of Brokerage Houses, this limitation introduced by law together with the "Guidelines" implemented by the KNF led to "reprofiling" the distribution of clients' results, including close out distribution margin.

Based on the research that ESMA quoted, the effect of limiting leverage in the form of improved results appears in markets that allow extremely high levels of leverage, e.g. 400: 1, to be used, and it is in these markets that restrictions should be introduced.

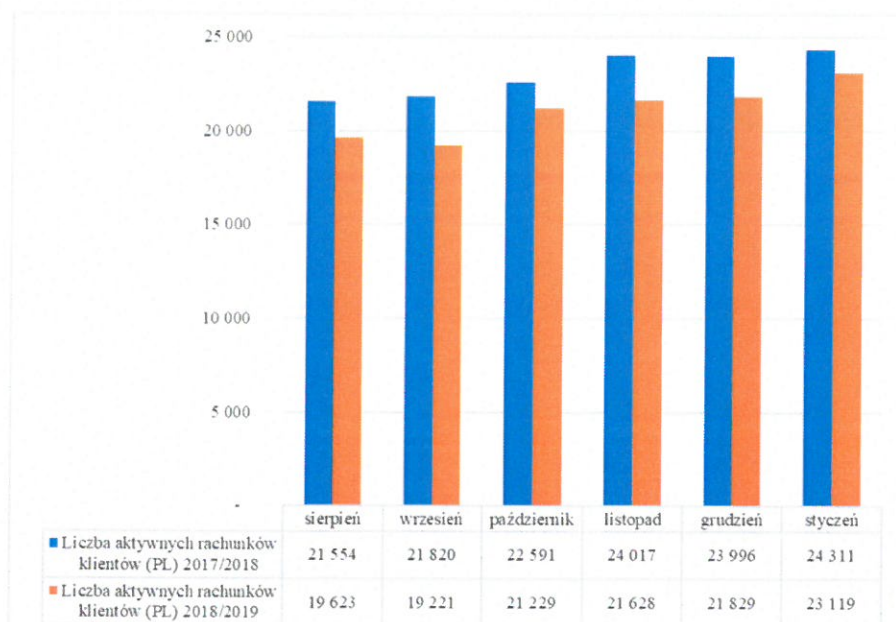
In Brokerage Houses Chamber's opinion:

- a) The effects of limiting the level of leverage in the form of improving clients results will occur in the case of entities that use very high leverage. Meanwhile, in Poland and some EU countries, it has been limited from the level of 50: 1 to 100: 1.
- b) Analyzing the research presented in the justification of ESMA's decision, we find that the lower the value of the leverage used, the smaller the effect on the rate of return. In the second quintile of the European portfolio and in the third quintile of American, the results of European investors before and after the reduction of leverage level are almost identical. It can therefore be assumed that in the case of lower leverage values, its further reduction does not affect the results achieved, and the effectiveness of such action, with ever lower values, becomes almost zero. Given the leverage restrictions in force in Poland, it is the effects from the last quintiles that may reflect potential future effects.
- c) Limiting the leverage significantly influenced the decrease in turnover of domestic brokers. This decrease was close to 50 percent while the authors in the study presented a decrease in turnover volume of 25%. This fact indicates that the model, assumptions and effects do not match the European market, even less the domestic one.

**Appendix 1.**

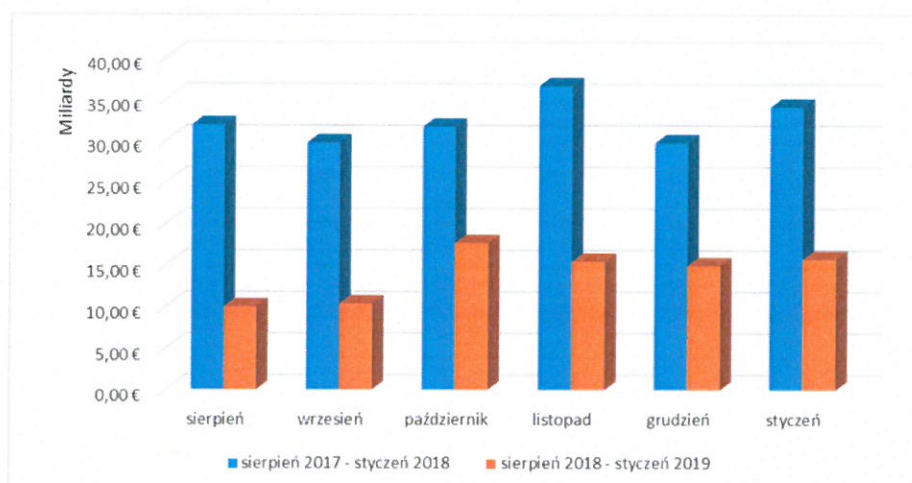
**Data from the Polish Financial Supervision Authority**

***1. The decrease in the number of active clients' accounts from Polish CFD suppliers p. 34***



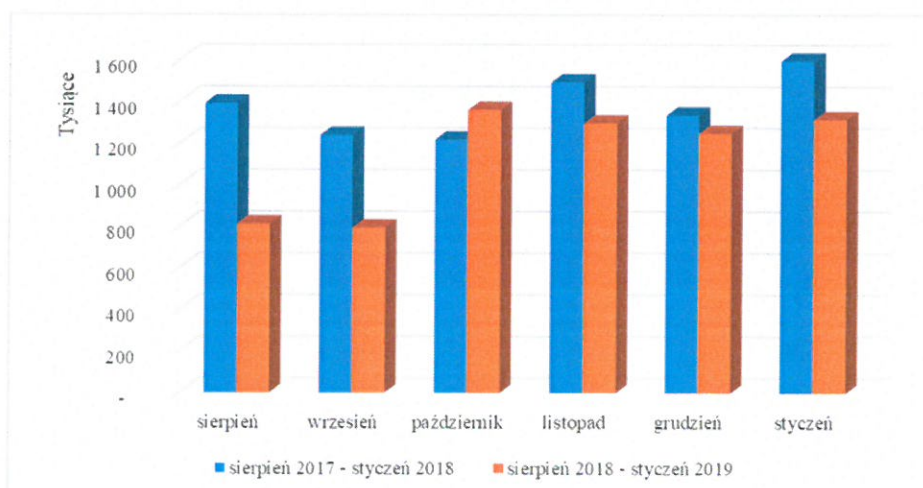
## 2. Volume decrease

The next chart illustrates a significant decrease in the volume of transactions concluded by retail clients in the area of contracts for difference to the same period last year. p. 35



## 3. The decrease in the number of transactions

There is also an evident decrease in the number of retail client's transactions in contracts for difference after the introduction of ESMA's product intervention, as illustrated in the chart below.



Therefore, the above data show that after the introduction of ESMA's intervention:

- number of active retail clients of Polish suppliers for difference contracts decreased,

- volume of transactions concluded by retail clients of Polish suppliers for difference contracts decreased, as well
- number of transactions concluded by retail clients of Polish suppliers of difference contracts decreased.