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31 January 2023

Comisión Nacional de Mercado de Valores (**CNMV**)
C / Edison nº 4 - 28006 Madrid.

Via email to: dge.supervision@cnmv.es

Dear Sir/Madam,

RE: RESPONSE TO CNMV'S PUBLIC CONSULTATION ON ADDITIONAL INTERVENTION MEASURES ON CFD TRADING | PEPPERSTONE

A. Introduction

The Pepperstone group of companies (**Pepperstone**) welcomes the opportunity to comment on **CNMV's** public consultation on the subject matter.

The present response is submitted by Pepperstone EU Limited, a Cyprus Investment Firm authorized and regulated by the Cyprus Securities and Exchange Commission (CySEC) with license No. 388/20, exercising freedom of services rights to other EEA-member states, including Spain. Our responses take also into consideration the international experience accumulated by the operations of other entities of Pepperstone, which are licenced and regulated by foreign regulators such as the Australian Securities and Investment Commission (ASIC), the UK's Financial Conduct Authority (FCA), the Federal Financial Supervisory Authority (BaFin), the Dubai Financial Services Authority (DFSA), the Kenya Capital Markets Authority (CMA) and others.

B. Key Points

Whilst Pepperstone broadly agrees with many of the recommended requirements which aim to address the issue of bad actors targeting inexperienced investors or those employing aggressive and inappropriate marketing tactics to the detriment of the retail investors' interests, we are concerned that any decision to prohibit the marketing, distribution and sale of CFDs and investment services and activities over CFDs by means of marketing communications to retail investors residing in Spain fails to take into account:

- **(a)** the clear demand for these products among experienced retail traders who want a low-cost option for speculative trading purposes; and
- **(b)** the legitimate EEA-regulated brokers who offer a genuine service and operate within the framework and under the obligations of MiFID II.

The imposition of these additional restrictions may have the undesired effect to limit the ability for Spanish investors to gain exposure to legitimate, licensed providers via their advertising and allow unscrupulous non-licensed entities who have no respect for any regulatory compliance (including marketing bans) to gain an advantage in accessing investors that do want the option to speculate on various assets. From a practical market experience, we understand that the product intervention measures of June 2018 which were adopted by the European Securities and Markets Association had the undesirable effect to drive away from EU-licensed entities those investors which did not want to be bound by those measures.

Marketing of CFD products by appropriately regulated entities from EEA jurisdictions should continue to be allowed in places where it can be targeted to appropriate audiences and it is reasonable to suggest the person viewing the advertising would understand the risks of financial trading. The same applies for sports sponsorship being about brand awareness and to those that do trade CFDs rather than for financial product exposure.

C. Responses to questions of the consultation

Section 3.2.1 of the consultation: Prohibition of marketing, distribution, or sale of said instruments and services through advertising communications

***Question**: Do you agree with the adoption of the prohibition foreseen in the proposed text, similar to that established in France? Please reason your answer*.

The proposed marketing ban on high-risk contracts for differences (**CFD**) products is towards the right direction to the extent it aims to address the issue of bad actors targeting inexperienced investors and especially those employing aggressive or misleading marketing tactics, but it fails to take into account the clear demand for these products among experienced retail traders who want a low-cost option for speculative trading purposes and the legitimate regulated brokers who offer a genuine service. A more nuanced approach to regulating marketing, rather than an outright ban, may be more appropriate. We also note the current CNMV proposed resolution is not consistent with the French legislative restrictions and is far narrower as it does not consider the different definition of a CFD.

All the new restrictions will do is further limit the ability for Spanish investors to gain exposure to legitimate, licensed providers via their advertising and allow unscrupulous non-licensed entities who have no respect for any regulatory compliance (including marketing bans) to gain an advantage in accessing investors that do want the option to speculate on various assets.

Pepperstone is a respected global company that currently operates under 7 financial services licenses. We are predominantly a “switcher” brand, in that few of our clients are new to CFD trading, the clear majority of our clients know the risks as they have already traded CFDs with other entities. Our company was founded in Australia over a decade ago and we are reliant on advertising to introduce our brand to investors in other jurisdictions who may not be as aware of us and our positive reputation.

Our clients are traders who believe they have an edge on various financial markets and who want to be able to make profits from small price movements without a large outlay. CFDs are unique in that they allow for speculation with lower costs than would be required to trade in the underlying assets, and in some cases allows for speculation in products that cannot be traded by retail investors on any formal exchange.

Speculative trading is becoming more popular with retail investors. In the past, retail investors may have traded more long/hold, safer strategies rather than speculatively, because they did not have the financial capacity or access to technology to be able to compete with the deep pockets and data of institutional strategic traders, especially with the fees they were charged. A typical traditional stockbroker could in the past charge 1.5% commission on trades for a small investor. If an investor were to invest just $1,000 on a share purchase, they could only make a profit if the market went up, because there is no short selling, and they would be charged a minimum of $30 for placing and closing out the trade. The share would therefore have to increase by $30 for the investor to break even when selling it, putting a speculative strategy out of reach for most individuals.

If the same investor purchases a CFD contract with leverage of 5:1, they can gain exposure to an asset that would normally cost them a minimum of $1,000 for as little as $200 or pay even less if they use fractional lot sizes. As they are contracts for difference, an investor will only pay the difference between what they buy and sell the CFD for, which means they never have to outlay the full amount. This enables them to have far stronger buying power and provides more opportunity for higher volume trading or multiple positions across financial products.

Access to both real-time and comprehensive information is a big driver in retail participation in the markets more generally and beyond simple share trading. It is only recently that technology has progressed to the point that allows retail investors to compete close to, and in some cases at, the same level of large institutional investors.

Retail investors now have access to:

- inexpensive or free real-time market information and company/market analysis, which in the past was typically only available via expensive data information companies and reports;
- close to real-time pricing and trading, whereas in the past retail spreads (the difference between the buy and sell price) were broad and there was often a delay to the quality of their data and trade execution which meant that retail investors were at a significant competitive disadvantage to institutional trading desks;
- increased computing power that is efficient and affordable, allowing for more sophisticated analysis on home computers; and

- reduced trading costs, allowing them to be able to speculate on market movements in a way that is now economically viable.

If anything, the above means that the availability of products such as CFDs are more popular with retail traders, particularly in falling or volatile global markets. Given their unique nature and the fact that CFDs now have negative balance protection, 50% margin close out ratios and numerous requirements for onboarding risk disclosure and appropriateness hurdles protecting retail investors, it is unclear why the CNMV would assume there is no discernible target market for them.

To suggest the loss ratios alone means a product is not suitable does not take into consideration how a speculative trader operates. Even day traders facilitating speculative trading on exchanges will lose similar percentages as all speculative trading carries a high degree of risk.

Suggesting the marketing of the CFDs and margin forex in Spain is leading to a material number of retail investors inappropriately gaining access to these types of products does not appear consistent with recent research.

The CNMV's consultation paper suggests that eight entities have 60,000 retail clients and account for almost 99% of total traded volume reported to the CNMV. The total complaints for those entities were 558 in 2020 and 531 in 2021. This suggests less than 1% of these clients are complaining in any year and it is also not clear that those complaints relate to a lack of understanding of the product. As CFDs are OTC products and are traded in high volume, it is common for clients to request trade investigations, for example, to confirm the price that they were provided was consistent with the available prices at the time. This may be classified as a complaint but clearly is not suggesting the product was inappropriate for the client, and once provided with clear objective price evidence, a client may be fully satisfied with that outcome.

The Australian Securities and Investments Commission (ASIC) also recently commissioned independent external research to examine investment behaviour since the advent of COVID.[1] The ASIC REP 735 *Retail investor research* report found:

- The most common product type held by investors was Australian shares (73% owned at least one of this product type, with a median of three different Australian shares held). The next most common were cryptocurrencies (44% owned at least one of this product type, with a median of three different cryptocurrencies held) and international shares (31% owned at least one of this product type).[2]
- Less than 7% of those surveyed held either CFDs or margin FX and of those that did:

[1] ASIC REP 735 Retail investor research 11 August 2022
[2] Ibid page 1.

- 97% of those that did hold those products said CFDs made up less than 20% of their overall portfolio;
    - 94% said margin FX made up less than 20% of their overall portfolio;[3]
- 0% of moderately experienced investors and only 1% of recent investors claimed to have purchased CFDs or Margin FX when they started investing.[4]
- Only 31% experienced realised losses in CFDs and 42% on margin foreign exchange. At the same time 52% lost on market linked notes, 47% on hybrid securities and 45% on ETOs.[5]

These results are consistent with Pepperstone's experience. CFD traders are often experienced in trading, and they are aware of the products' high-risk nature. As a result, those that do trade tend to only invest a fraction of their portfolio in these types of instruments. It is also not a very commonly traded product. The general public are not typically accessing these types of products except via fraudulent schemes, which will continue to target vulnerable investors with their infrastructure and similar hard selling practices if CFDs are banned, just using other financial products, such as crypto.

Alternate suggestion

We have no objection to several of the suggested CFD product marketing restrictions where the marketing is clearly not targeted and open to the general public, such as advertising being banned on social media sites, in television, cinema, and radio advertisements etc.

However, marketing of CFD products by appropriately regulated entities from EEA jurisdictions should continue to be allowed in places where it can be targeted to appropriate audiences and it is reasonable to suggest the person viewing the advertising would understand the risks of financial trading. For example, banners should be able to be displayed through the contextual targeting (based on keywords targeting) where someone makes search for CFD or searched for speculative trading options or for a company name of an entity that offers CFDs. It is reasonable to suggest that a person looking for this type of speculative product should be given the opportunity to be informed of regulated entities operating in that space. Banners should also be allowed on websites that are clearly related to financial market information or the trading of financial products. Again, it is reasonable to suggest that investors who frequent those types of sites understand financial markets and the higher risks associated with trading CFDs.

This is also mindful of the fact that no CFD product is distributed at this point in time, with investors still needing to complete a comprehensive onboarding process as is required in EU-regulated jurisdictions under the MiFID II appropriateness requirements. Many issuers who

[3] Ibid Figure 6.
[4] Ibid Figure 14.
[5] Ibid page 6.

operate a legitimate offering and onboarding process will confirm that less than 20% of those that begin onboarding, finalise their onboarding, primarily because of the rigor and complexity of that process driven by regulatory requirements, including KYC requirements, economic profiling of the client and an appropriateness assessment.

The CNMV should also utilise any current legislative powers it has to force the correction of and punitively punish any misleading and deceptive advertising being undertaken in Spain. The advertising concerns raised by the CNMV paper would surely fall within this category. It is misleading and deceptive to claim that it is “easy and safe money” or that you will “multiply your income every day without any prior knowledge”.

In addition, the CNMV should consider strengthening any anti-hawking regulations prohibiting the unsolicited sale or promotion of any financial product to individual retail clients and prohibit cold calling, unsolicited phone calls, unsolicited emails, or door-to-door sales. As well as having stringent clear consent withdrawal requirements that easily allow for a retail client to withdraw any marketing consent preventing any further marketing contact from firms and penalties associated with firms ignoring that request.

The example of France and the restrictions applicable in France

Should the CNMV consider implementing the French marketing restrictions, we highlight that the CNMV would need to change its definition to match the French definition if it is to be consistent. The Autorité des Marchés Financiers does allow the marketing of non-exchange traded CFD derivatives provided they do not have one of the following characteristics:

1. The maximum risk is not known at the time of subscription;
2. The risk of loss is greater than the amount of the initial financial contribution;
3. The risk of loss in relation to any corresponding benefits is not reasonably understandable given the particular nature of the proposed financial contract.

This current CNMV CFD definition does not allow for this type of limited risk CFD to be available to investors and is therefore far more restrictive.

We again highlight that a complete restriction on all marketing, even where people are searching for or investigating CFDs will merely advantage non-regulated fraudulent firms.

Question: *Do you agree with the prohibition to include specialised media? Should you believe that the proposed prohibition should be limited to general mediums, please reason your answer, include if possible a definition of specialised media and how you think the audience of the specialised medium can be guaranteed to be made up exclusively of professional investors*.

In our view, product specific marketing bans should be limited to places where it would not be reasonable to assume that the audience would reasonably be interested in a high-risk speculative product or at least understand the risks of speculative trading. Specific examples of places where it could never be assumed that the audience would fall within this category would include, on general social media platforms, in the cinema, on tv and radio, excluding financial professional channels.

As highlighted above, the ability to provide information via banner adverts to investors who have clearly searched for the products previously, or on sites where it is likely to be a mix of professional and retail traders who understand the markets and the risk of trading, should continue to be allowed. This enables those that have a clear understanding and a desire to trade these types of products with access to the information they need about who is appropriately regulated.

Additional anti-hawking restrictions prohibiting unsolicited direct contact and ongoing marketing consent restrictions would also assist to protect retail investors.

Section 3.2.2 of the consultation: Additional prohibition of sponsorships and brand advertising

Question: *Do you agree with the implementation of a restriction on sponsorships and brand advertising, as established in France, when the Entity's object or effect, corresponding to its main activity whether direct or indirect, is the advertising of CFDs? Please reason your answer*.

We support the reasoning that an entity which is not fully based in Spain should not be sponsoring any Spanish based sporting teams, especially if the sole object or effect is the advertising of CFDs products. However, we do not agree that all sports sponsorships or brand awareness marketing should be banned. We believe the sponsorship restrictions should be limited to product advertising only.

The Pepperstone Group conducts some global sporting event sponsorships as well as team sponsorships in Australia, but in all cases are careful to ensure it is only our brand that is being marketed and not the product.

The purpose of sports sponsorship for Pepperstone is not to attract investors that are new to CFDs but for retention of current clients and attracting switcher clients (those that have traded the product before). It is a way for us to create brand awareness to those that do trade CFDs who see these sponsorships as representing a level of success obtained as a business. This is a legitimate purpose.

On the other hand fly-by-night organizations do not sponsor long term global sporting events.

Our reasoning for sports sponsorship being about brand awareness and not financial product exposure is further supported by ASIC REP 735 *Retail investor research* where an independent study found that only 4% of those surveyed even remember seeing an advertisement about any financial product at a sporting event.[6] This clearly indicates that it is not a suitable method for financial product delivery to the general public.

As a final remark, we are conscious that the matter should also be reviewed from the perspective of the freedoms provided under the EU laws and regulations for the establishment and operation of the internal market and therefore, in practical terms, sponsorships and brand advertising that is not expressly targeted to Spain but also to other EU member states or to a wider international audience should also be considered to be expressly exempt.

Section 3.2.3. of the consultation: Additional restrictions on remunerations and other sales techniques.

Question: *Do you agree with the implementation of such restrictions to the remuneration system of commercial networks and to some or all the remaining sales practices mentioned herein? Please reason your answer*.

We are supportive of many of the restrictions, although we believe many are already prohibited under current MiFID II legislative requirements among the EEA jurisdictions.

There is a practical issue with the banning of cash payments from credit cards in that many people now operate a debit card that can also access credit if necessary and it may not be possible to distinguish which aspect of the card is being used. Further, within Spain and the EU area in general, credit institutions have established rigorous procedures on the amount of credit limits they provide to their clients on credit cards, which takes into account their economic profile and financial vulnerability. In any case, Pepperstone EU Limited has certain thresholds and as a matter of policy would reject to onboard these categories of clients whose financials and their economic situation expose them to vulnerabilities.

We are therefore of the opinion that the use of credit cards is not highly correlated to investors' vulnerability and that the ban of their use does not add value to the ultimate goal of protecting retail investors.

There is also very clear disclosure that our products are high risk and that you should not invest more than you can afford to lose. We therefore believe it would be highly unlikely that someone would use a cash payment on a credit card to facilitate a transaction, and so

[6] Ibid Figure 6.

believe this is unnecessary. It may be more likely in scenarios where a fraudulent entity is interacting with a client in which case there would be other concerns.

Section 3.2.4 of the consultation: Extension of the restrictive measures to other leveraged instruments.

Question: *Do you agree with applying the marketing restrictive measures to leveraged instruments that are not CFDs, as is the case in other European jurisdictions, to properly protect retail clients? In your opinion, what measures would be reasonable and adequate to properly protect the investor? What specific instruments do you believe should the measure include? Please reason your answer***.**

In general, we are of the opinion that CFDs should not be singled out.

We are of the view that marketing practices such as unsolicited calls and emails, high pressure selling practices, conflicted client introduction and retention bonuses, for example, are inappropriate and practices that should be banned, rather than applying marketing restrictions to certain products.

While it is concerning for any retail investor to expose themselves to losses greater than they can afford to lose, assuming any investment with leverage will lead to such an unacceptable retail loss is simply not accurate.

Leverage is a feature that simply provides the ability for an investor to increase their buying power. In the case of CFDs, that have negative balance protection and the only requirement is to pay the difference between what you buy the product for and what you sell it for, this means your actual financial exposure is far less than what you would have been required to outlay if you had purchased the underlying asset itself.

It should be noted that some of the most extreme unacceptable marketing practices that have led to significant fraudulent activity, all of which are identical to the main concerns raised in this consultation, have previously been associated with binary options and now with cryptocurrency, neither of which are leveraged products. This again demonstrates it is the fraudulent entities and their practices and not necessarily the product that is the issue.

Question: *Do you agree with applying the restrictive measures of initial margin protection and margin close-out protection included in the CNMV Resolution of 27 June 2019 to the other indicated leveraged instruments? Do you think that the other measures set out in said Resolution, namely the negative balance protection, the prohibition to provide retail clients with benefits, and the mandatory provision of risk warnings, should also apply to these other instruments*?

We are of the view that all of the proposed protections can be beneficial, if implemented in a proportionate and reasonable manner. CFDs should not be singled out.

Section 3.3. of the consultation: Alternative possibility to establish a prohibition on OTC trading platforms.

Question: *Would you agree with the possibility of introducing a prohibition similar to that on the marketing, distribution or sale of CFDs through electronic platforms in Belgium after considering that the measures proposed as a first option may be insufficient to achieve the desired protection of retail investors?*

We would strongly discourage the CNMV from introducing this type of restriction. As we have noted in responses to other questions in the consultation, there is a clear demand from certain retail investors to be able to speculatively trade financial products in a cost-effective way. Prohibiting the distribution and sale of CFDs will simply encourage investors (regardless of categorisation or experience) to trade offshore, potentially outside of any regulatory oversight or protection, especially that applicable in the EU under the MiFID II/ MiFIR regime.

Section 3.4 of the consultation: Other matters.

Question: *Do you think there are any other relevant issues or do you have any comments on the proposal of a Resolution?*

We would argue one of the key reasons why the ever-increasing regulation in the CFD industry does not appear to be addressing the harms that regulators are concerned with is because the restrictions are merely impacting legitimate entities and their informed clients. They are not actually focused on the real harm, which can occur regardless of the product. We would therefore encourage the CNMV to make a critical distinction between:

(a) fraudulent activities such as:

- Outright scams;
- Misrepresentations about the regulatory status of an individual/entity or the regulatory protections offered to an investor;
- Misrepresentations about the risk or structure of a product or service;
- Misleading information as to the entity offering the product or service;
- Inappropriate marketing of a financial product or service;
- False claims about the performance of an investment opportunity;
- The deliberate targeting of vulnerable investors;

(b) the scenario where a retail investor has not been unreasonably marketed to by a validly EEA-regulated entity, and has made a fully informed decision to trade a high risk product either in the pursuit of speculative trading or to hedge out other underlying exposure with minimal outlay.

Please let us know if we can provide any additional information on the matters we have raised in this submission.

Yours faithfully,

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