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Regulation of the Financial Services and Markets Authority regulating the distribution of certain derivative financial instruments to retail clients, approved by Royal Decree of 21 July 2016

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The Financial Services and Markets Authority,

Having regard to the Law of 2 August 2002 on the supervision of the financial sector and on financial services, Article 30*bis*, first paragraph, 1°;

Having regard to the opinion of the Consumer Affairs Council, issued on 18 February 2016;

Having regard to the opinion of the Supervisory Board, issued on 2 May 2016;

Hereby decrees:

Article 1. Definitions

For the purposes of this Regulation, the following definitions shall apply:

1° "derivative financial instrument": any financial instrument referred to in Article 2, first paragraph, 1°, *d), e), f), g), h), i)* and *j)* of the Law of 2 August 2002;

2° "binary option": a derivative instrument which (a) confers the right to a pre-determined return if the option is exercised or expires in the money and (b) does not confer a right to anything if the option is not exercised or expires out of the money;

3° "leverage": any procedure, whatever its legal nature, that makes it possible to increase the consumer's exposure beyond the amount the latter has allocated to the transaction concerned;

4° "credit card": an electronic payment instrument that makes it possible in particular to make payments and withdrawals using a credit reserve;

5° "consumer": a consumer within the meaning of Article I.1, first paragraph, 2° of the Code of Economic Law.

Article 2. Derivative instruments whose distribution to consumers is prohibited in Belgium

It is prohibited for anyone to distribute to one or more consumers in Belgium, on a professional basis, any derivative instruments traded via an electronic trading system, where those instruments

1° are binary options;

2° have a duration of less than one hour, not counting periods during which the duration of the instrument may be extended; or

3° directly or indirectly involving leverage.

Article 3. prohibited forms of distribution

It is prohibited for anyone distributing to one or more consumers in Belgium, on a professional basis, derivative instruments traded via an electronic trading system, to use one or more of the following distribution techniques:

1° granting a reward of any kind whatsoever to existing clients who bring new clients or prospects or who recommend to others the derivative instruments being offered or services related to those instruments;

2° granting (a) a gift, bonus or any other sum to a client, except if the client may obtain the value in cash without having to fulfil any conditions, or (b) any other advantage, the actual granting of which depends on the execution of transactions in the derivative instruments being distributed;

3° using external service providers that operate call centres for contacts with clients or prospects;

4° using any software designed, developed or sold by providers whose remuneration is determined, directly or indirectly, in full or in part, based on the amounts collected by the undertaking in question, earned by the latter of lost by clients in the course of distributing the products in question or services related to them;

5° granting any third party involved directly or indirectly in the distribution a remuneration determined, directly or indirectly, in full or in part, based on the amounts collected by the undertaking in question, earned by the latter or lost by clients in the course of distributing the products in question or services related to them;

6° allowing the funds necessary for executing transactions to be paid by credit card.

Article 4. cases to which this Regulation does not apply

This Regulation shall not apply to:

1° derivative instruments admitted to trading on a regulated market or on a multilateral trading facility operated by a market operator;

2° derivative instruments granted as a form of remuneration within the terms of an employment contract.

This Regulation does not apply to distribution to consumers who are treated as professional investors under the criteria set out in Annex A, II to the Royal Decree of 3 June 2007 laying down detailed rules for implementing the Markets in Financial Instruments Directive.

Article 5. Entry into force

This Regulation shall enter into force on the date the Royal Decree approving it enters into force.

During the two months following the entry into force of this Regulation, and notwithstanding the provisions of Article 2, distribution of the derivative instruments referred to therein shall continue to be authorized for purposes of settling transactions already underway at the time of the entry into force of the Regulation.

REGULATION OF THE FINANCIAL SERVICES AND MARKETS AUTHORITY GOVERNING THE DISTRIBUTION OF CERTAIN DERIVATIVE FINANCIAL INSTRUMENTS TO CONSUMERS

Commentary

This document contains the explanatory memorandum on the FSMA Regulation governing the distribution of certain derivative financial instruments to consumers.

In accordance with Article 30*bis* of the Law of 2 August 2002, the Regulation was submitted to the Consumer Board and to the FSMA Supervisory Board for an opinion. A public consultation on the draft regulation was also held, by way of publication on the FSMA's website between 8 and 25 January 2016.

The FSMA took account of the reactions received in the course of the aforementioned consultations insofar as those were justified with a view to the objectives of the draft regulation.

I. General considerations

Article 30*bis* of the Law of 2 August 2002 on the supervision of the financial sector and on financial services enables the FSMA to lay down regulations that, taking into account the interests of users of financial products or services, prohibit or impose restrictive conditions on the distribution or certain forms of distribution to retail clients of financial products or of certain classes of financial products.

This provision confers on the FSMA a power of appreciation, which allows it to assess whether a financial product has features that might cause the FSMA to restrict or prohibit its distribution.

The FSMA has had occasion to make use of this power in the past, when it adopted the Regulation of 3 April 2014 on the ban on the distribution of certain financial products to retail clients. That Regulation bans the distribution to retail clients of certain financial products that are, by their very nature, unsuitable for distribution to retail clients, such as traded life policies, financial products the return on which depends directly or indirectly on a virtual currency, as well as investment instruments and Class 23 insurance products tied to non-mainstream assets.

The FSMA noted that certain types of particularly risky derivative financial instruments were being distributed to the public in Belgium via electronic trading platforms. These instruments are presented by their promoters as making it possible to obtain high returns at a time of historically low interest rates.

Among these are, in particular, instruments that involve each party undertaking to pay the other a predetermined amount if the price of a given asset (listed share, currency, commodity, index, precious metal, etc.) changes in a predetermined direction after a period of time that is sometimes very short (a few seconds or minutes), or if a specified event occurs. This type of instrument is generally referred to as a binary option.

Other derivative instruments, such as contracts for difference and certain forex instruments, sometimes involve significant leverage, which exacerbates the risk inherent in such instruments.

The FSMA has observed that the distribution of such financial products posed serious problems for the protection of consumers of financial products:

- As regards the nature of the instruments in question, it has been noted that some of them, in particular binary options and similar instruments, are extremely risky and even arbitrary in nature, and have nothing in common with an investment or a financial transaction in the traditional sense of the term. A binary option in fact is the equivalent of a bet placed on the change in the value of an asset generally over a very short period of time: the instrument gives rise to payment of a predetermined sum by one party to the other in the event that the price of the asset in question changes in the direction chosen by the latter party. These instruments have a very short maturity, often reduced to a period of only a few seconds or minutes. It is also important to consider the binary, 'all of nothing' character of this sort of option, which further reinforces the arbitrary nature of the instrument. Such instruments are not based on economic fundamentals and are therefore – despite their designation as financial instruments – purely arbitrary. Thus they do not enable the investor in question to make an investment in the classic sense of the term.

- The instruments mentioned above often involve significant leverage, which further increases the associated risk. The use of leverage allows for the exposure of the consumer to exceed the actual amount he or she invested. Different procedures can be used for the purpose: in the case of some instruments, the consumer must, for example, deposit a certain amount (the margin) with the provider prior to the execution of the operation in question. The amount corresponds to merely a fraction (often very low, a few percent) of the notional value of the instrument in question.

  By using leverage, the potential gains and losses will exceed the amount actually invested by the consumer – and may even be a multiple of that original sum. In other words, the use of leverage may result in the consumer losing an amount much higher than the original investment, even where there may be only minor changes in the absolute value of the underlying asset. Where, for example, the leverage is set at 5 (that is, if the margin, or the amount actually invested by the consumer, is the equivalent of 20% of the notional value of the instrument), the entire amount invested will be lost if the change in the value of the instrument reaches 20% of the price of the underlying asset.

  In the case of some instruments, the transaction is set to terminate if the fluctuations of the notional value of the instrument in question exceed the amount on margin (stop-loss). Where, for example, the leverage is set at 5 (that is, if the margin or amount actually invested by the consumer is the equivalent of 20% of the notional value of the instrument), the entire amount invested will be lost if the change in the value of the instrument reaches 20% of the price of the underlying asset. In this scenario, the use of leverage has the effect of increasing the risk of loss of the amount invested, especially in the case of a volatile underlying: the higher the leverage, the greater the risk of losing the entire sum invested.

  It should be noted, however, that there are situations where the blocking mechanisms mentioned above remain ineffective (sudden changes in the market, for example - such as the case of the sudden rise in value of the Swiss franc on 15 January 2015). Hence these mechanisms do not offer complete security.

  There are also certain mechanisms that allow for postponing a position. They make it possible to avoid an immediate loss by putting up an additional margin. In practice, the effect of such measures is that an uninformed investor will be likely to put up an amount that exceeds what he or she had initially planned to spend on the operation, instead of taking the loss on the original amount.

- The derivative financial instruments in question are not listed on a regulated market or on an MTF and do not go through any central clearing.

  Since they are not listed on a regulated market or MTF, the client's counterparty will in some cases be the provider itself, or a company associated with the provider. In addition to the risk inherent in derivative financial instruments in general, it seems that the instruments being considered here are often sold by persons who are structurally in a conflict of interest with the buyers. In such a situation, the position taken by the operator will therefore always be the opposite of that of the investor, so that a loss sustained by the latter constitutes a gain for the operator, and vice versa. The operator of the platform thus has no interest whatsoever in the client realizing a return.

It is important to note in this regard that the IT infrastructure that makes it possible to carry out the operations in question and to settle the transactions is put in place by the operator of the platform and does not depend on a market or a central counterparty. The transactions carried out are settled using computer software that is internal to the trading platform and that automatically calculates the result of the operation. In this regard we wish to emphasize that most of the time there is no guarantee as to the integrity of the platforms in question (see also the discussion below).

These are instruments that are not standardized and the definition of their terms varies from one provider to the next.

- The instruments concerned are offered via electronic platforms that in themselves also entail potential risks for clients. At first glance these computerized tools may appear simple from the client's point of view, and they are conceived in order to place the client in an environment that gives the impression that he or she is acting as a true trader with a great deal of autonomy.

  Yet there have been documented cases where the electronic platforms used by the providers offering the derivative instruments in question made it possible in reality to manipulate certain parameters so as to systematically disadvantage the client and thus favour the provider who was the client's counterparty. The parameters that are liable to such manipulation include, notably:

  1) the conditions that determine whether a transaction is approved or rejected by the platform. The platform will thus not accept transactions that are likely to generate a loss for the provider and a gain for the client;

  2) the introduction of an artificial delay before a transaction is executed. Given the very short maturity period of some of the instruments in question, this method makes it possible to manipulate the results of the transactions;

  3) the asymmetrical allocation of the gains or losses linked to the price movements between the time a transaction is approved and the time of its execution (asymmetric slippage).

  Moreover, the development of these platforms is often entrusted to third-party providers who specialize in this area. Here, too, there is a risk of conflict of interest insofar as the remuneration of the companies who develop the tools is often tied not to the sales figures but to the profit they enable the investment firms to generate, and thus to the losses sustained by the investors in question.

  It should be noted that such problems are not limited to over-the-counter instruments. Certain financial institutions have recently been investigated in the United States and in Europe – leading in at least one case to an agreed settlement with the financial institution in question – for the use of software making it possible to slow down the speed of transmission of price information sent to clients so as to give the financial institution an advantage over the latter.

- The distribution model used relies on direct marketing and on-line advertising techniques (banners and pop-ups that appear on high-traffic websites such as news sites, social networks and free messaging services, personalized advertisements, unsollicited communications).

The emphasis is generally placed on the prospect of gain that these instruments offer and their alleged simplicity, although in fact these products are marked by a particularly high risk of loss and a high degree of complexity.

The technical facilities offered by using the internet enable the providers in question to address their advertisements to the appropriate target group and to establish databases of potential clients, based notably on tracking visits to the websites in question. Potential investors are then contacted directly, often in an unsollicited fashion (cold calling), and urged to invest.

Once an initial payment has been made, the client is contacted repeatedly in order to gain his or her loyalty and urge him or her to invest larger amounts: some practices observed in this regard come close to harassment. The providers in question generally use the services of call centres for this purpose, supervision of which seems in many cases to be inadequate. New clients are frequently granted a 'bonus', which takes effect only on condition that the amounts the client invests reach a certain threshold. The bonus cannot be withdrawn immediately, but must be allocated to operations on derivative financial instruments. In some cases, existing clients who bring new clients are also given a reward (affiliate system).

As mentioned above, it appears that the providers used by the operators of the platforms in question for carrying out their activities (call centres, developers of the software used) are often remunerated on the basis of the amounts received, or of the losses sustained by the investors, thus creating a situation of conflict of interest that renders the distribution model unsuited to distributing risky and complex products to consumers. This aspect also renders illusory the notion that compliance with the conduct of business rules suffices to protect investors.

- Dishonest practices have been identified in an abnormally high number of cases. Some of the providers in question are engaging in their activities unlawfully, not complying with the requirements for authorization and prior approval imposed by the applicable law. Based on complaints received by the FSMA, it appears that withdrawal requests by investors wishing to recover their investments are often not honoured; there are numerous disputes in this regard. Cases of transactions carried out without the client's authorization and of unauthorized use of credit card numbers have also been identified. Lastly, in a number of cases there are indications that the software used by the platforms do not faithfully reflect the behaviour of the underlying market; they are conceived in such a way as to manipulate the execution parameters of the transactions or to allow clients access to market information only after the platform (see above).

The distribution of such derivative financial instruments to consumers has led to significant losses on the part of the investors in question. It follows that the FSMA was faced with a very significant number of complaints by investors who had sustained substantial losses as a result of transactions in these types of instruments.

A report by the Autorité des marchés financiers (AMF) on the results achieved by individual investors trading in CFDs and forex in France indicates that over an observation period of four years, between 2009 and 2013, on transactions carried out by almost 15,000 clients in France, the percentage of clients who lost money was as much as 89%, with an average loss of EUR 10,887 per client and a median amount of EUR 1,843. Significantly, the study shows that investors who traded the most (in terms of the number of transactions and the average amount of each transaction or cumulatively) lost the most.

The same is true for those clients who stayed in for longer periods, thus illustrating that there is no benefit from experience gained over time. The results of this study have yielded the following observations:

- The experience gained by an investor or the fact of being an informed investor does not guarantee a positive return. There is thus no justification for distinguishing between consumers who are informed investors and others. The arguments put forward during the public consultation, to the effect that a distinction should be made between these two categories of investors, have therefore not been taken into account. This is of course without prejudice to the fact that a consumer may, under certain circumstances, ask to be treated as a professional investor (see below);
- It is important to bear in mind that the aforementioned study covered a long period, during which the financial markets as a whole saw a very favourable performance, thus setting aside any explanation that would attribute the poor results to a downward economic trend. This makes it possible to affirm that these types of products lead to losses regardless of the general economic situation;
- The AMF study looked only at investment service providers authorized to carry out their activities in France. The arguments made during the public consultation to the effect that a distinction should be made between actors who are lawfully carrying out their activities and hold the requisite authorizations, and those actors who carry out their activities unlawfully, therefore have no merit. The aforementioned study thus indicates indisputably that the investors concerned sustained an unacceptable level of loss, even where they were dealing with authorized providers.

The observations made by the AMF are corroborated by other studies conducted by other regulators. The FSMA does not see any reasons why the Belgian market would be so different in nature as to invalidate the conclusions of these various studies. During the consultation, some actors argued that the results of such studies should be nuanced, insofar as they also include transactions made by private individuals in order to cover their portfolio. The FSMA does not agree with this analysis: this type of particularly complex investment strategy is not pursued by a significant number of investors, so that the practice – assuming its has been verified – should have only a marginal effect on the results.

Lastly, it is significant that there is no professional market for some of the products concerned (in particular, binary options): these are thus instruments that are exclusively the object of distribution to consumers via trading platforms. The FSMA considers that the absence of such a professional market in binary options (unlike for the majority of the other financial products) is a negative indicator of the quality and fairness of this type of product.

A number of measures had already been taken in the past regarding this type of actor, not only by the FSMA but also by foreign and international authorities. Thus, the FSMA has published warnings about the risks associated with investments in these types of product. Other authorities, such as the AMF in France (see the large number of warnings published on its website regarding providers who engage in their activities unlawfully) also took comparable steps, as did ESMA (see *Investor Warning* of 28 February 2013). The FSMA also published a communication addressed to firms that distribute non-mainstream financial products online (such as CFDs, binary options, etc.) (see Communication 2014_05 of 25 July 2014), in order to make the firms in question aware of their legal obligations.

It appears that in spite of these steps, the practices identified above continue and the existing legal framework has not been able to ensure adequate protection of investors.

We wish to recall that pursuant to the Law of 16 June 2006 on public offers of investment instruments and admissions of investment instruments to trading on regulated markets, the public offer of such products in Belgium gives rise to the obligation to publish a prospectus. This obligation does not suffice, however, to ensure that clients are provided with information. It does not cover the elements concerned by the envisaged measure and does not make it possible to respond to the serious problems of investor protection mentioned above, which are of a different nature.

The FSMA has, moreover, noted that many other Member States of the European Union and even some third countries have adopted restrictive measures regarding the distribution of such instruments. Thus we have seen that regulatory measures or bans were imposed on CFDs and/or binary options in the United States, Japan, Quebec and Turkey. In Switzerland, offering derivatives on foreign currencies is reserved to credit institutions. The use of leverage is also limited in different ways in a number of jurisdictions (Hong Kong, United States, Poland, Ontario, Japan, Turkey, Singapore).

For these reasons, the FSMA considers it opportune to regulate the distribution of over-the-counter derivative financial instruments to consumers.

The measures proposed here are justified as well in terms of protecting the image and reputation of the financial sector.

As to the advisability of adopting the present Regulation, the Consumer Board rightly stresses in its opinion that the problem described here is not limited to Belgium, and that it should thus in due course receive a response at European level. The Consumer Board adds that the initiative taken by the FSMA can serve as the first step in that process, and that it should be accompanied in particular by steps taken by the national supervisory authorities of Member States where the providers have their registered office. The FSMA fully supports this vision and emphasizes that it is in this context that it has drawn up this Regulation. The framework put in place at the Belgian level is intended in any case to be re-evaluated in the light of new developments on the market (the appearance of new products or in appropriate practices, for example), as well as any new initiatives that may be taken at European level.

II. The regime put in place

The approach used in this Regulation is based on two axes. The first of these targets certain derivative instruments that are, by nature, always unsuitable for distribution to consumers. The second axis enumerates a certain number of aggressive distribution methods and prohibits their use.

A. *Scope*

The scope of the Regulation was defined in such a way as to cover strictly the limits of the phenomenon observed. To this end, the FSMA took into account the comments made by the Consumer Board.

The provisions of the Regulation apply to the distribution in Belgium on a professional basis, to one or more consumers, of one or more financial instruments as referred to in Article 2, first paragraph, 1°, d), e), f), g), h), i) and j) of the Law of 2 August 2002, where these are traded on an electronic trading platform. The various parts of this definition are explained in detail below:

- Distribution is understood to mean: "presenting the product, in any way whatsoever, with a view to encouraging the client or the potential client to purchase, to subscribe to, to adhere to, to accept, or to sign up for or open the product in question" (see Art. 30*bis*, second paragraph, of the Law of 2 August 2002).

In what follows, we specify the relationships between the notion of distribution and that of a public offer.

Distribution within the meaning of this Regulation does not require the product to be presented to a minimum number of clients or prospects. The Regulation is thus all the more applicable to cases where public offers are made, that is, to communications addressed to more than 150 people (Article 3, §1, first paragraph, of the Law of 16 June 2006). It follows that an application for approval of a prospectus for operations that are prohibited by the present Regulation cannot be validly submitted to the FSMA and such a prospectus cannot in any case receive approval by the FSMA.

It should be noted in this regard that the provisions of the Regulation are aimed not only at protecting the specific interests of consumers but also those of the community as a whole, whose interests lie in the integrity of the financial sector and public confidence therein. The present Regulation therefore contains public policy provisions.

- The Regulation applies to distribution to consumers. By way of a definition of the latter term, it refers to Article I.1, first paragraph, 2° of the Code of Economic Law. Within the meaning of that provision, a consumer is "any natural person who is acting for purposes that do not fall within the framework of his or her commercial, industrial, trade or professional activities".

  Distribution of the instruments referred to herein to a natural person who carries out a commercial, industrial, trade or professional activity falls within the scope of the Regulation if that person is acting in the capacity of managing his or her private assets (and thus outside of his or her professional activity).

  It likewise follows from this definition that the Regulation does not apply to legal persons, and in particular, that the distribution of derivative financial instruments to companies does not fall within its scope. Such activity does not entail the same risks and is therefore not equivalent to the phenomenon being targeted here.

  The Regulation does not apply to distribution to consumers treated as professional investors in application of Annex A, II of the Royal Decree of 3 June 2007 laying down rules for the transposition of the Directive on Markets in Financial Instruments. The scope of Article 30*bis* of the Law of 2 August 2002 is also respected, notwithstanding the reference to the notion of consumer.

  The Regulation does not apply to the granting of derivative financial instruments as remuneration within the terms of an employment contract. Share option plans are thus excluded from the scope of the Regulation. Moreover, the granting of this type of remuneration within the terms of a service contract with a self-employed provider is already excluded, given the definition of the term consumer.

- The Regulation thus applies solely to the distribution of instruments traded via an electronic trading system. The notion of electronic trading system is used in ESMA's Guidelines on systems and controls in an automated trading environment for trading platforms, investment firms and competent authorities. It covers all forms of electronic infrastructure by means of which a financial instrument is traded.

  The Regulation only applies to over-the-counter instruments. It thus does not apply to the distribution of instruments admitted to trading on a regulated market or on a multilateral trading facility operated by a market operator. These two types of market infrastructure allow the interests of multiple buyers and sellers to come together and are thus multilateral in nature. The FSMA considers that this multilateral element, as well as the settlement systems associated with it, in itself offers a guarantee to the consumer. For this reason, it does not seem advisable at this stage to extend the prohibition to those types of instruments. The approach taken by this Regulation is similar to the one adopted in the United States.

- The regulation applies to distribution within Belgium, regardless of the nationality or the place of establishment of the person distributing the instruments concerned. It does not apply, therefore, to the distribution abroad by a person established in Belgium.

  To determine whether or not distribution is involved, it is necessary to determine whether or not the distribution is addressed specifically to the Belgian public, looking at indications such as the presence of specific information on the Belgian legal regime (particularly the tax regime), referral to contact persons in Belgium, the absence of a disclaimer indicating that the distribution is not addressed to the Belgian public, the language used, the possibility for Belgian clients to register on line, etc. The fact that an undertaking has notified its intention to provide investment services in Belgium under the regime of the freedom to provide services is also considered an indication that offers will be directed specifically to the Belgian public. Distribution will likewise be considered to be carried out in Belgium if advertisements for the instruments are disseminated via media within the territory of Belgium. We wish also to refer in this regard to the case law of the European Court of Justice regarding the criteria used to determine if a commercial activity is 'addressed to' the Member State where a specific consumer his domiciled (see CoJ, 7 December 2010, joined cases C-585/08 and C-144/09 (Pammer and Alpenhof)).

B. *Elements of the regime*

The regime put in place is made up of two axes which apply cumulatively, each without prejudice to the other.

a) <u>Ban on distribution</u>

The distribution ban applies to the derivative financial instruments which the FSMA considers to be unsuitable, by virtue of their intrinsic characteristics, for distribution to consumers.

The Regulation is thus intended to prohibit distribution of those financial instruments referred to in Article 2, first paragraph, 1°, *d), e), f) g), h), i) and j)* of the Law of 2 August 2002 and that fall within one of the following categories:

- The first axis of the prohibition is aimed at binary options, whose harmful effects on consumers has been demonstrated by the considerations set out above. Given the variety of forms that such types of instruments may take, the Regulation applies to binary options in light of both their maturity and their binary nature.

  Article 2, 1° of the Regulation specifically targets the binary, 'all or nothing' character of binary options. Thus the distribution ban applies to instruments whose characteristics are to entitle their owner to a fixed payment (determined when subscribing to the instrument) if the option is exercised or if it reaches maturity with an intrinsic value (in or at the money) or, conversely, to give the owner no payment at all if the option is not exercised or if it reaches maturity without any value (out of the money). It should be noted, therefore, that the amount due at maturity one way or the other will be determined not by the magnitude of change in the price of the underlying asset, but solely by the direction in which that price changed. As emphasized above, these instruments are tainted by a fundamental conflict of interest, given that the client's counterparty and that of the person distributing the instrument are one and the same or related persons, and that the operation is a zero-sum game in which one party's constitutes the other's gain. It is thus unacceptable for such instruments to be distributed to consumers, especially according to the modalities set out above.

Article 2, 2° of the Regulation applies specifically to instruments whose maturity is less than one hour. Instruments with a maturity of less than that period are not suited to retail clients. Given the volatility inherent in the operation of markets over the very short term, this type of product is in effect highly speculative or even arbitrary in nature and therefore does not have the same foundations as a regular financial transaction.

In calculating the maturity, periods for which the maturity of the instrument may in some cases be extended are not taken into account. Moreover, it is important to bear in mind that the measures envisaged apply only to instruments whose maturity, at the time when the contract is entered into, is less than one hour. Instruments that may be closed out early and notably within one hour of signing the contract are not targeted, provided of course that the original maturity agreed was over one hour. The maturity period taken into consideration is thus the one originally agreed in the contract, and not the actual maturity of the instruments.

- Problems have likewise appeared on the market as regards the distribution of other types of derivative instruments traded on electronic trading systems, notably contracts for difference (CFD) and certain forex instruments.

  The FSMA takes the view that at this stage, the intrinsically inappropriate nature of this type of instrument for consumers has not been sufficiently demonstrated, notwithstanding the fact that the instruments have caused significant losses to consumers (see in particular the AMF study cited above).

  Given the said information, which demonstrates the risky and complex nature of these instruments, the FSMA nevertheless takes the view that a ban on distribution to consumers of derivative instruments traded on electronic trading systems using leverage is justified. In light of the products considered here, the very principle of using leverage thus seems problematic. The use of leverage – whether set at a 'low' or 'high' level – has the corollary effect of accelerating the losses sustained by the consumer; moreover, it may also have as a consequence that the consumer loses more than the amount invested.

  It is the combination of the different factors involved, notably, distribution to consumers of complex and risky OTC instruments with the use of leverage, trading via electronic trading systems whose integrity is not always verified, after using aggressive distribution methods, that has led the FSMA to draw this conclusion.

  As envisaged by the Regulation, the notion of leverage refers to "any process, whatever its legal classification, that allows the consumer's exposure to be higher than the amount the latter invested in the transaction in question". It applies, in particular, to mechanisms by which the potential amount of the consumer's loss or gain is higher than the amount originally invested in the operation.

  This position may be re-evaluated in future, and where appropriate could move towards stricter measures, targeting specific products, for example, depending on new developments on the market.

- During the consultation, alternative prohibitive measures were proposed.

One actor suggested an alternative to limiting the leverage, consisting of setting a minimum amount for client accounts. This suggestion was not followed, however. It was deemed that such a provision risked simply pushing clients to invest more and thus to increase the potential amount of the loss.

Two actors proposed that the distribution of OTC derivative instruments by parties other than credit institutions be prohibited. This alternative measure was not followed at this stage. It was thought that the consistency of such a measure with European law and the principle of non-discrimination would require further study.

The FSMA observes that the provision thus put in place is close to the one in force in the United States: in that country, a distinction is made between listed and unlisted derivative instruments. Only the distribution of the latter is subject to restrictions.

b) Ban on certain modes of distribution

The second axis of the regulation prohibits certain specific modes of distribution.

This article applies without prejudice to the other legal or regulatory provisions governing permissible market practices and modes of distribution. The Code of Economic Law continues, of course, to apply: the rules it contains in respect of cold calling and unsollicited communication as well as, more generally, in respect of sales practices must also be complied with.

The objective of this article is to target distribution practices that are in any case unsuitable for the distribution of over-the-counter derivative financial instruments to consumers or may even be considered abusive, given the inherent characteristics of these instruments.

As regards the concerns expressed by the Consumer Board about the second axis of the Regulation, we wish to specify that the scope of the Regulation now extends only to distribution to consumers, so that many of the questions raised are no longer relevant. Moreover, the provisions whose contents were close to those of other regulations (restrictions on unsollicited communications, for example) are no longer included.

The following methods fall within the scope of the ban:

- The use of call centres for contacts with clients or prospects

  Aggressive communication techniques used by the providers in question (see above) rely on the use of external call centres for contacts with clients or prospects. Having regard to the particularly complex nature of derivative financial instruments, such a practice is not acceptable: contacts with clients must be handled by staff who are adequately trained and over whom the firm in question has sufficient control. External providers who offer a call centre service do not appear to offer sufficient guarantees in this regard, in particular given the risky nature of the financial instruments being considered here.

- Granting any reward whatsoever to existing clients who bring in new clients or prospects or who recommend to others the derivative instruments or related services being offered

  In the context of the distribution of derivative financial instruments, the use of a pyramid-type scheme in which existing clients are rewarded if they bring in new clients is not acceptable. Such procedures heighten the risk that derivative financial instruments will be distributed to persons for whom such products are not appropriate. The distribution of financial products must be carried out by professionals of the financial sector who have the necessary authorizations to do so.

Concerning the remark made by the Consumer Board in this regard, the FSMA takes the view that the scope of this provision is not identical to that of Article VI.100, 14° of the Code of Economic Law, concerning pyramid schemes. That provision applies, in fact, to situations in which "*the consumer pays a sum in exchange for the possibility of receiving consideration deriving largely from the entry of new consumers into the system than from the sale or consumption of products*." This is not the object of the practice targeted by the Regulation: the granting of the consideration is solely an 'accessory' mechanism and not the principal object of the relationship between the consumer and the provider.

- Granting (a) a gift, bonus or any other sum to a client, unless the client can withdraw that amount in cash without any conditions being imposed or (b) any other benefit that can effectively be collected only on condition that certain transactions are carried out in the derivative instruments being distributed.

  One of the distribution techniques used by operators of the platforms in question consists in offering new clients a bonus that can only be collected on condition that their investments reach a certain threshold or that operations are carried out for a set volume. Generally speaking, this bonus can be applied only to transactions in derivative instruments on the platform in question and is therefore largely fictitious in nature: the sole objective of such a practice is to ‘capture' the client. Such a technique is not appropriate for the distribution of derivative financial instruments to consumers.

  It should be noted that this provision does not target price discounts granted by a provider. In the latter case, the client is free to dispose freely of the amount of the discount (since it is deducted from the price).

- Inadequate modes of remuneration

  In certain cases, it appears that the remuneration of service providers who conceived, developed or distributed the software used for concluding the operations carried out, or of persons who participate concretely in distributing the derivative financial instruments in question, was determined by the sums paid by clients or by the amounts lost by the latter.

  Such distribution methods are to be prohibited, insofar as they exacerbate the fundamental conflict of interest inherent in derivative financial instruments in which the vendor of the product is at the same time the client’s counterparty.

  The mechanisms by which, for example, the development costs of a software programme are shared between companies of the same group based on the turnover of each company do not fall within the scope of this provision, which applies solely to third party providers.

- Methods of payment accepted

  The Regulation prohibits providers from accepting credit cards for payment of the funds required to execute transactions.

  This provision supplements the prohibition against using leverage as referred to above: a credit card in effect allows a person to make payments using a renewable credit reserve. The FSMA wishes to point out as well that numerous cases of fraudulent use of credit cards have been noted, so that it seems appropriate to ban the use of this method of payment.

C. Entry into force

The draft Regulation enters into force on the date when the Royal Decree approving it comes into force.

Execution of transactions in the financial instruments referred to in Article 1 remains possible, however, for 2 months after the date of entry into force, solely for the purpose of settling existing transactions.

The effect of this Regulation thus in no way nullifies transactions under way at the time of its entry into force.

III. Application of European law

A number of specifics are provided below regarding the relationship between the present Regulation and European law.

The present Regulation applies only to distribution within Belgium to consumers. It will not apply, therefore, to firms that are active exclusively abroad.

The Regulation is of course limited to settling questions that are not subject to maximum harmonization by the European directives applicable to financial matters. Nor does it apply to existing European passporting regimes.

This Regulation is thus outside the scope of Directive 2003/71/EC of the European Parliament and of the Council of 4 November 2003 on the prospectus to be published when securities are offered to the public or admitted to trading and amending Directive 2001/34/EC, and of the passporting regime established by it. In its first axis, the Regulation effectively puts in place a form of 'product' regulation, which imposes minimum requirements as regards the inherent characteristics of products distributed to retail clients. In its second axis, the Regulation governs the methods of distribution used. It is therefore not of the same type and does not pursue the same goals as Directive 2003/71/EC, which concerns investor information.

The Regulation also falls outside the scope of Directive 2004/39/EC of the European Parliament and of the Council of 21 April 2004 on markets in financial instruments amending Council Directives 85/611/EEC and 93/6/EEC and Directive 2000/12/EC of the European Parliament and of the Council, and abrogating Council Directive 93/22/EEC, which has to do with the provision of investment services and not with the regulation of products or distribution practices. It should be pointed out in this regard that there is a distinction between the rules governing the provision of investment services as envisaged by the MiFID Directive, which concerns the contractual relationship between the client and the financial service provider, and the rules governing authorized market practices.

The same conclusion can logically be drawn with respect to Commission Directive 2006/73/EC of 10 August 2006 implementing Directive 2004/39/EC of the European Parliament and of the Council as regards organizational requirements and operating conditions for investment firms and the definition of terms for the purposes of that Directive. Therefore there is no need for the FSMA to apply Article 4 of that Directive.

Article 2 of the present Regulation regulates a domain that is already covered by Directive 2005/29/EC on unfair commercial practices. That directive specifies, however, that as regards financial services, Member States are free to impose more restrictive or more rigorous conditions than those provided for in the domain harmonized by the Directive.

Even where Member States adopt - as here - measures in areas not harmonized by the European directives, they are still required to comply with the general principles of EU law. Measures that impose restrictions on free circulation of capital or the free provision of financial services are allowed only on condition that they are non-discriminatory, are adopted for overriding requirements in the general interest, are likely to guarantee the achievement of the objective sought and do not go beyond the objective sought.

In this regard, it should be emphasized first of all that the measures taken apply to the same extent to actors located in Belgium and those established in another Member State. They are thus not discriminatory in nature.

As indicated in the detailed exposé above of the regime put in place, the products referred to in Article 1 of this Regulation are, by virtue of their inherent characteristics, unsuitable for active distribution to consumers. With a view to protecting this category of persons and in order to contribute to the smooth operation and good reputation of the markets and of the financial sector, it is therefore justified to prohibit their distribution. The same observation may be made regarding the second axis of the Regulation: the methods of distribution referred to therein are such, given their aggressive nature, that they render derivative financial instruments unsuitable for distribution to consumers. Such objectives incontestably meet the criterion of overriding requirements in the general interest.

Given the problem posed in such cases and the objectives of the Regulation, it would seem, moreover, that there is no less radical technique available to offer adequate protection to consumers. As emphasized above, this Regulation effectively prohibits, in its first axis, the distribution of certain products to consumers because of the inherent characteristics of the said products, which render them unsuitable for such distribution. In its second axis, the Regulation addresses specific sales techniques which are inappropriate given the inherent characteristics of the financial instruments in question. For these reasons, alternative measures, such as the imposition of additional obligations regarding information provision, would not be appropriate in light of the aims of the Regulation.

In addition, the FSMA takes the view that the distribution of derivative instruments to consumers according to the modalities mentioned here, and the significant problems that result therefrom, are such as to affect consumer confidence in the financial sector, and thus to hamper the smooth operation of the European Union's internal market.

Lastly, the restrictive measures do not go beyond the objective pursued. They have no effect on the distribution of the products in question to professional clients, their effect being limited to the category of consumers.