Questions and answers document regarding the implementation of the CNMV's Resolution of 11 July 2023 on product intervention measures relating to financial contracts for differences and other leveraged products

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This document is not regulatory. The objective is to pass on to the sector and, specifically, entities providing investment services related to CFD and other leveraged products, interpretation criteria for an appropriate application of the obligations resulting from the Resolution of 11 July 2023 of the National Securities Market Commission on product intervention measures relating to financial contracts for differences and other leveraged products.

INTRODUCTION

On 14 July 2023, the Resolution of 11 July 2023 of the National Securities Market Commission on product intervention measures relating to financial contracts for differences and other leveraged products (hereinafter, the Resolution) was published in the Spanish Official State Gazette (BOE) in aims of intensifying the intervention measures implemented in 2019 in the Resolution of 27 June regarding product intervention measures concerning binary options and financial contracts for differences.

Since its publication, several consultations from entities have been addressed, answering to queries on the first part of the Resolution on additional measures for financial contracts for differences and on the second part on restrictive measures on other leveraged instruments. This has led to the publication of this Q&A document, to ensure that the Resolution is applied homogeneously by the sector and to respond to the most relevant issues raised by the entities that have consulted the CNMV.

1. Questions and answers related to the first part of the Resolution (One. Additional measures on financial contracts for differences)

1.1. In relation to the scope, is a potential retail investor resident in Spain forbidden from investing in CFDs through the platform of a registered intermediary?

No. The Resolution prohibits the advertising of CFDs and other business practices in Spain, regardless of the client's place of residence, but not the trading itself. The sale of CFDs is allowed, as long as it is executed at the sole initiative of the investor. Therefore, the Resolution does not imply changes in the way retail investors can trade CFDs through intermediaries of which they are already existing clients, nor does it prevent them from opening new CFD trading accounts, provided that entities comply with all regulatory obligations, particularly the obligation to assess and inform clients, bearing in mind that CFD trading is, in general, not suitable for retail investors.

1.2. With regard to an entity's website, is free access to CFDs on the website without any limitation or restriction allowed? Can there be a demo account on the website hosting different products in addition to CFDs? What if the entity is contacted by the client or keeps evidence in its records that its clients or potential clients have requested, by their own initiative, to open a demo account for CFD trading?

It would be acceptable for an entity's website to grant investors free access to CFD trading, as long as the information provided on such products is neutral, that is, it corresponds to strictly legal information describing the characteristics and risks of the product and the service offered. Therefore, an entity is not allowed to include promotional information of such products on its website.

Free access to CFD demo accounts free of charge or for a symbolic price is not appropriate, even if a multi-product account is also used for CFDs. In such a case, the entity should remove CFD trading from the demo account.

Accessing a demo account that is not free of charge or has a symbolic price is permitted, as long as, considering its educational nature, the client has due knowledge and experience, and the entity has been able to verify and can certify this prior.

1.3. More specifically, with regard to restrictions on training, is the provision of training content, such as seminars, webinars, manuals, etc., offered to registered clients, permitted as long as this content is not aimed at enhancing or promoting CFDs? Does it also affect clients who opened an account before the Resolution's entry into force?

The Resolution prohibits the advertising to the general public of training in CFD trading, demo accounts and webinars and other materials with CFD training content or encouraging investment in this type of product when offered free of charge or with a symbolic price, excluding from the prohibition legal information documents and media on the characteristics and risks of the product and the service provided. General training on CFD trading to retail clients with proven knowledge and experience is permitted.

The restriction applies to educational material offered after 3 August 2023, even if the client was recruited before such date.

1.4. Regarding the prohibition of brand sponsorship and advertising, what does "a very small part of the entity's offers" mean? If an entity is forbidden brand advertising, may it advertise specific products that are not CFD? May it disclose or publish market analysis? Would be admissible to maintain sponsorship in communications and content to retail investors outside of Spain?

The prohibition is established, among other reasons, as a particular response to indirect advertising of CFD trading through, for example, t-shirts at sporting events. The Resolution forbids any event or organisation sponsorship operation and brand advertising whenever their purpose or effect is to directly or indirectly advertise CFDs, except when it is proven that such sponsorship or brand advertising does not intend to offer such products or services, particularly when it is proven that CFD transactions are only "a very small part of the offers".

In addition to intending to limit, as stated herein, indirect and general advertising of CFD trading with the use of a brand or the name of an entity through sportswear, this prohibition implies that the entity cannot advertise to the general public, not even specific products other than CFDs if the promotional effect is similar.

Nonetheless, in the given case that the entity certifies that the purpose of brand advertising or sponsorship is to replace the CFD offering with other specific products that differ from CFD products in its business model, thus making the CFD activity "very small", it could be understood that advertising of the specific non-CFD products would be permitted.

Additionally, the CNMV has considered, as a supervisory criterion, that, in order for it to be "a very small part of the entity's offers", the entity's general activity related to CFD should not exceed 20% of the total trading in financial products (taking into account the notional amount for leveraged products) within the previous 12 months. The CNMV also takes into account the supervisory interest of such issue, considering the number of clients trading CFDs and the revenues reported by the entity for said product. Therefore, if, surpassing said 20%, the number of clients of the entity trading CFDs

throughout the year is less than 50 and the annual revenue amount does not exceed 500,000 euros, the activity would also be considered, in principle, as "very small" and, therefore, brand sponsorship or advertising does not necessarily have to have CFD trading as its primary objective.

Entities subject to the prohibition for brand sponsorship and advertising may distribute market performance information through its website, as long as it is neutral and does not promote CFD activity. On the other hand, videos discussing market information or technical analysis on channels that may be contracted by the entity or on the Internet are not considered admissible when they include a reference to the entity, its logo or brand.

According to the Resolution, the restriction on advertising activity, sponsorships and brand advertising affects the activity carried out in Spain, both by established entities and by entities operating under the freedom to provide services regime. In principle it does not include activity outside Spain, except in the case of CFDs whose underlying is a cryptoasset that is not considered a financial instrument under MiFID. However, if a sponsorship executed outside Spain has a similar impact as if it were carried out in Spain, the subject entity must take on effective measures to remain in compliance with the Resolution applicable to retail investors in Spain.

1.5. Can information on CFDs be disclosed by the sales force? Is any marketing incentive to the sales force or business development prohibited?

According to the Resolution, any form of advertising of the general trading of CFDs is prohibited. Marketing incentives associated to CFDs and retail clients are prohibited. The provision of legal information of such type of products is permitted, this not being so in the case of commercial information.

1.6. In relation to affiliates and external partners, is the use of external partners or collaborators to inform interested clients allowed?

Current regulations do not allow turning to collaborators or independent third parties or unregistered partners who carry out reserved activities, such as the acquisition of clients and offering investment products and services. The marketing of investment services and client acquisition are activities reserved to investment firms or tied agents (Article 129 on activity restrictions and designation of Spanish Law 6/2023 of 17 March on Securities Markets and Investment Services).

1.7. In regard to the prohibition on credit card deposits by retail clients, may clients make deposits in their corresponding accounts with a debit card?

Yes. The Resolution only mentions credit cards, in so far as the investor uses financing to invest.

2. Questions and answers related to the second part of the Resolution (Two. Restrictive measures applicable to other leveraged instruments)

2.1. Should the second part of the Resolution be deemed to be applicable to listed derivatives as well as OTC derivatives? Does it also apply to derivatives with a hedging purpose? Does the Resolution apply to residents and for Spanish as well as foreign products?

The second section of the Resolution establishes that financial instruments, other than those indicated in the first part of the Resolution, whose "maximum amount at risk at the time of

subscription is either unknown or is greater than the amount initially invested" fall under its scope; therefore listed and OTC derivatives, including those with hedging purposes, are subject to the Resolution. Moreover, it shall be applicable to Spanish and foreign products.

Additionally, the characteristics to be complied with by instruments for them to be subject to the Resolution are not cumulative but independent from each other, it being sufficient to comply with one of the following: (i) its maximum amount at risk being unknown at the time of subscription; or (ii) the potential loss being greater than the amount initially invested. Therefore, the only derivatives that would not meet the definition are, exclusively, purchased options or warrants, as the amount at risk is both limited to the initial contribution (premium) and is known at the time of subscription. On the other hand, instruments for which no initial contribution or premium is required (such as swaps or forwards) clearly have a risk of loss and, therefore, the potential loss is greater than the initial contribution (zero).

In relation to hedging purposes, it is worth highlighting that derivatives are not, per se, hedging or investment, but this will depend on the purpose intended by the client for the derivative. In any case, when the purpose of the instruments is to hedge business transactions or positions in other instruments, they shall also be subject to the Resolution. However, in the case of foreign exchange derivatives, if the requirements in Article 10 of Commission Delegated Regulation (EU) 2017/565 of 25 April 2016 are met, they shall not be considered financial instruments but a means of payment. Therefore, they would not be instruments subject to MiFID and would not fall within the scope of application of the Resolution or other securities market conduct of business rules.

Lastly, in regard to the scope of application relative to the client base, the Resolution applies to "retail clients in Spain", including non-residents. Therefore, an intermediary operating in Spain must apply the Resolution to all its clients, even if they are non-residents.

2.2. Relative to derivatives subject to this Resolution and to the application of EMIR regulations, should margin requirements also be reported according to EMIR and, if so, how should they be reported?

It is worth recalling that the CNMV's Resolution of 11 July 2023 does not modify the notification obligations established by the EMIR. Therefore, if leveraged instruments, as defined in the Resolution, and the margins required by the Resolution fall within the scope of EMIR, they will be subject to the same notification obligations as all other contracts that fall under said regulation.

2.3. How is the initial margin calculated? Can the client's overall position be considered to determine when to close the position?

According to the Resolution, the minimum initial margin required is the lowest amount among that corresponding to the type of underlying asset established in the CNMV Resolution of 27 June 2019 and the amount required by the trading venue where the instrument is traded.

With regard to the "payment of the initial margin" mentioned in the Resolution, for the composition and calculation of the minimum initial margin required, entities are deemed to be able to consider margins of an equity or financial nature deposited in the derivatives operational settlement account, as well as the client's global position held effectively by the entity, considering its fair value (in line with a generally accepted methodology), including spot positions.

As long as the client has open positions, the entity must verify whether the position close-out protection is applicable. To do so, it must check if the sum of the funds in the operational account in

such instruments and the unrealised net gains on all open derivative contracts associated with such account amount to less than half of the total margin provided for all such open contracts.

In this sense, to determine whether the 50% threshold established in the Resolution is reached at any given time, the "initial margin required" may be calculated interchangeably by the entities, as agreed with the client, considering the margin required by the market (or that established in the 2019 Resolution if lower) at the time, or the margin required by the entity and provided by the client.

On the other hand, in order to determine if the client's funds have dropped, or not, below half the required minimum margin at any given time, entities may calculate, in addition to the sum of the funds in the operating account in these instruments and the unrealised net gains, the client's overall position, as previously stated when indicating the determination of the composition of the initial minimum margin required.

For the purposes of position close-out protection, it is important for entities to carry out verifications with the due frequency and for them to have tools to react to extraordinary market movements in time. As soon as one of the controls identifies the case scenario considered in the Resolution for position close-out protection (or its approaching occurrence), in the event that the protection scenario is maintained, the client must be informed to give the opportunity to provide additional margins before the entity proceeds to close the positions.

2.4. What requirements are needed to take the client's global position into consideration both to determine the initial margin and for the purposes of position close-out protection?

Entities must have the appropriate tools and systems to measure and monitor the risks of all margins and positions.

On the other hand, entities must be able to certify that the client is duly informed of this, specifically that the position held with the entity covers the potential losses generated by derivatives trading, and that the client has agreed to it.

2.5. Regarding position close-out protection, can a client waiver a position close-out? Can the client's position be closed before reaching the threshold set in the Resolution?

With regard to ""position close-out protection", one or more open derivative instruments of a retail client must be closed when the sum of the funds in the operating account of such instruments and the unrealised net gains of all open derivative instruments associated with that account fall below half the total initial margin required for all open positions. The Resolution does not allow entities to accept a client's waiver to position close-out protection.

In line with the Resolution, position close-out must not take place before reaching the threshold provided therein and the entity must notify the client of the possibility of providing new margins and, therefore, avoid position close-out or agree on position close-out if deemed appropriate. Otherwise, the closing of positions before reaching 50% would imply the materialisation of losses that could otherwise be recovered. This means that the Resolution aims to, on the one hand, require minimum initial margins that limit the maximum leverage and, on the other, to ensure that the entity does not close positions before using 50% of the minimum margins required at any given time.

In any case, the accounts of clients trading with derivatives should not be in debit unless the entity's financing is properly reflected in the contract previously formalised with the client as, before this

happens, the entity must require the client to make an additional margin contribution and, with this failing to occur, the entity must proceed to close the positions.

2.6. How is the Resolution applied to derivatives with hedging purposes?

As stated under questions 2.1, the Resolution is applicable to derivatives with hedging purposes. In the case of derivatives contracted for hedging purposes, entities are permitted, when determining the initial and additional margins required, to assess the client's previous global position and, consequently, it must be interpreted that these derivatives contracted for hedging purposes, precisely to reduce the financial risks assumed by other financial positions or business transactions, will not be subject to the requirements set out in the second part of the Resolution, regarding the initial margin requirement and position close-out protection, since they would be contributing to reducing a risk, not to increase or create it, and the maximum risk incurred by the client would be known upon contracting.

In this sense, hedging must be effective, with the derivative mitigating the financial risks assumed by other specific and identified pre-existing financial positions or business transactions, and the entity distributing the derivative previously verifying that it substantially fulfils such purpose. In the case of interest rate hedging derivatives associated to loan operations contracted with the financial entity itself, the purpose of the hedging is deemed to be proven.

However, whenever the derivative ceases to serve a hedging purpose (due to a change in the status or composition of the client's portfolio, financial positions or business transactions), the entity must monitor the application of the Resolution's measures and request, where appropriate, the corresponding margin, as well as provide the client position close-out protection where applicable and if the client does not increase the margin to the necessary level after having been informed appropriately.

Thus, the Resolution allows entities, in compliance with the relevant requirements and holding the appropriate monitoring tools, to distribute hedging derivatives to retail clients without applying the measures established in the Resolution. In the case of there being no evidence that the derivative has hedging purposes, entities must comply with the initial margin and position close-out protection restrictions.