



FINANCIAL PLANNING STANDARDS BOARD

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VIA EMAIL

FPSB Comment on IOSCO Consultation Report on Retail OTC Leveraged Products

Dear IOSCO Board,

Financial Planning Standards Board Ltd.¹ appreciates your invitation to provide feedback from the global financial planning community on Retail OTC Leveraged Products, the potential risks they present, and measures IOSCO members can put in place to protect retail investors.

As the global standards-setting body for financial planning, FPSB's vision is to establish financial planning as a global profession so that members of the public can identify and access the services of competent and ethical financial planning and financial advice professionals. FPSB represents a global network of 26 nonprofit member organizations that have certified more than 175,000 CERTIFIED FINANCIAL PLANNER professionals, and additionally several hundred thousand financial advisers, around the world.

FPSB will respond to this consultation through the rubric of financial planning – a client-centric, process-driven professional practice that can provide consumers with confidence in financial intermediaries and markets, and context within which to evaluate the suitability of complex products or services. FPSB welcomes the development of appropriate measures for the distribution of retail OTC leveraged products to protect investors. We believe financial planners who adhere to competency and ethical standards, who provide advice and products to clients in the client's best interests, and who comply with the obligations of being a member of a professional community, have an important role to play in supporting IOSCO members seeking to better protect investors using retail OTC leveraged products.

FPSB's comments to IOSCO's consultation reflect the collective experience of FPSB and our 26 member organizations in developing professional competency, ethics and practice standards for the global financial planning profession. We welcome the opportunity to work cooperatively with IOSCO members in the development of guidance and measures to protect retail investors. If you have questions, or would like additional information, please contact me at +1-720-407-1902, or nmaye@fpsb.org.

Best regards,

Noel Maye, CEO

¹ Financial Planning Standards Board owns the international CERTIFIED FINANCIAL PLANNER certification outside the U.S., and develops and operates certification, education and related programs for financial planning organizations to benefit the public. FPSB has a nonprofit member organization in the following 26 territories: Australia, Austria, Brazil, Canada, Chinese Taipei, Colombia, France, Germany, Hong Kong, India, Indonesia, Ireland, Israel, Japan, Malaysia, New Zealand, the Netherlands, the People's Republic of China, the Republic of Korea, Singapore, South Africa, Switzerland, Thailand, Turkey, the U.K. and the U.S. As of 31 December 2017, there were 175,573 CFP professionals worldwide. For more information, visit fpsb.org.

Financial Planning Standards Board Ltd.

Question: Do market participants agree that the measures included in this toolkit are appropriate for addressing the specific risks arising from the offer and sale of OTC leveraged products to retail clients?

FPSB General Comments

(1) Require Fiduciary-Like / Client Best Interest Duty of Care

FPSB recommends that IOSCO expand its intervention measures for retail OTC leveraged products to include an additional measure:

- **Measure 10: Requirement for Intermediaries to Deliver Complex Products to Retail Investors with a Fiduciary-Like/Client Best Interest Level of Care.**

FPSB acknowledges that rolling-spot forex contracts, contracts for difference (CFDs) and binary options (BOs) are valid investment tools, and some collective investments or investment trusts (such as closed-end investment companies) use them in portfolios that are sold to retail investors. The key issue is how retail investors use these OTC leveraged products, or more appropriately, how retail investors are enticed to use them, and then (in the majority of cases) lose from them.

FPSB is concerned that retail investors make investment decisions absent a sufficient duty of care from intermediaries; absent specialist advice in the nature and risks inherent in these types of complex, volatile products; and absent a defined goals-based approach to investing.

IOSCO should consider whether it is appropriate that these products are typically offered through online trading platforms and sold without the provision of investment advice. FPSB would suggest that IOSCO consider a guidance to its members that retail investors accessing OTC leveraged products should be advised during the process. And that all financial advisors and financial planners who provide investment products or guide investing decisions should be appropriately qualified to assess the suitability of a given investment in the context of each client's goals, needs and objectives, and provide products and services in their client's best interest (ideally with a fiduciary level of care).

Similar to the best execution obligations contained in MiFID Implementing Directive, Article 21 (that investment firms take all reasonable steps to obtain, when executing orders, the best possible result for their clients), IOSCO members around the world should ensure that retail OTC leveraged product providers and intermediaries are suitably qualified to guide investors on investment decisions and to address the fiduciary duty an investment firm owes its clients.

FPSB supports the notion that an investment firm or investment advisor should place the interest of the client first, at all times acting honestly, with the utmost good faith, and in a manner the advisor reasonably believes to be in the best interest of the client. This would involve being able to reconcile the concentration of risk and potential for loss inherent in retail OTC leveraged products with a client's financial position and overall financial objectives.

(2) Protection Measures May Be Inadequate in the Face of Information Asymmetry, Mis-Aligned Interests

FPSB supports IOSCO's call to its members to consider, to the extent legally permissible in their jurisdiction, informing investors about the features and risks of the products and the firms offering them, or restricting the marketing or sale of OTC leveraged products to retail investors.

FPSB welcomes IOSCO's risk reduction measures in the areas of leverage limits, pricing methodologies, restrictions on certain marketing activities and prohibition on the sale and/or distribution by intermediaries of OTC leveraged products to retail investors.

When it comes to such products, retail clients deserve to have the highest level of protections in place regarding duty of care, required disclosures and management of conflicts. The issue is not only one of information asymmetry; it's also an issue of intent with regard to how the complex and volatile products are marketed and sold to retail investors. A European study² recognized that while limited financial literacy or asymmetric information may contribute to a customer's inability to make sound decisions about complex retail financial products, other factors, such as limited time to fully understand the products, processes of persuasion, personal interaction and trust also play a role in decision-making. The report asserts that belief formation can be subject to framing effects or biases, such as overconfidence.

FPSB is concerned that the aggressive marketing and incentives offered during distribution of retail OTC leveraged products fail to adequately describe, in a way understandable to retail investors, the inherent risk of rapid, large and unexpected losses (amplified by leverage) that can result from investing in forex contracts, CFDs or BOs. How these products are marketed and sold at present appears to mask the fact that the vast majority of retail clients trading in these products lose money.

A September 2017 Bloomberg article³, Ronaldo Is Hawking One of the World's Riskiest Derivatives, described how CFD investors in Spain lose money 82% of the time. According to a Comision Nacional Del Mercado de Valores study, 31,000 investors in Spain lost 142 million euros over a 21-month period ended in September 2016, including transaction costs. In 2014, the French Autorité des Marchés Financiers highlighted findings showing that nine out of 10 French investors in retail CFD products lost money, with average losses over four years of nearly €11,000.⁴

FPSB encourages IOSCO to gather data from IOSCO members on the performance of these products and providers in the retail space to recalibrate protection measures as appropriate.

(3) Is It Time To Clarify The Purpose of Retail Investing?

FPSB supports the prohibition on the marketing, distribution or sale of binary options (BOs) to retail clients.

According to IOSCO's own consultation document, some regulators question whether products such as binary options (BOs) can ever fulfill a genuine investment need and are concerned that the short-term nature of these contracts may encourage repeated transactions that can present addiction-like risks leading to large losses. Acknowledging that retail investors have diverse needs from their investments, FPSB would propose that encouraging investment products that incite addictive gambling behavior should not be promoted or supported by the global IOSCO or professional advice community.

² Chater, Huck and Inderst. Consumer Decision-Making in Retail Investment Services: A Behavioural Economics Perspective. November 2010.

³ "Ronaldo Is Hawking One of the World's Riskiest Derivatives," 20 September 2017, www.bloomberg.com/news/articles/2017-09-21/ronaldo-touts-500-1-leverage-derivatives-that-regulators-loathe

⁴ 2014 Autorité des Marchés Financiers Study of Investment Performance of Individuals Trading in CFDs and Forex in France, www.amf-france.org/en_US/Actualites/Communiqués-de-presse/AMF/annee_2014.html?docId=workspace%3A%2F%2FSpacesStore%2F96c52a14-3900-464f-8fff-7d4700ff37e3

FPSB Comments on the IOSCO Measures

Measure 1: Requirement for firms offering the relevant products to retail investors to be licensed

{This measure would require market intermediaries to be registered and/or licensed by a relevant regulatory authority when physically based in and operating from that jurisdiction and offering the relevant products to retail investors, regardless of where the end-investor is located.}

FPSB supports this measure. Additionally, FPSB supports:

- Encouraging jurisdictions to characterize OTC leveraged products as financial instruments to ensure firms offering them are licensed as financial intermediaries, and that the IOSCO measures can be applied to them.
- Requiring intermediaries that deal with retail clients to be locally licensed, whether physically located in the jurisdiction or not.

FPSB is unclear about IOSCO's guidance stating that locally-licensed intermediaries would be prohibited from dealing with retail clients residing in other jurisdictions. Assuming the intermediary met the requirements of licensure in each jurisdiction where it dealt with retail clients, whether located in the jurisdiction or not, wouldn't the intermediary be able to be multiply licensed for different jurisdictions?

Measure 2: Requirement for firms to incorporate a prescribed minimum margin requirement for retail investors

{This measure would require market intermediaries to comply with minimum margin requirements when transacting in CFDs or rolling spot forex contracts, ensuring that they collect from their clients a certain margin amount as collateral before opening a position. The measure can also be applied so that it requires a certain level of margin to be maintained to support a position over the course of the trade.}

Retail investors are attracted to these complex products because they focus on the upside of leverage – for a low initial capital input (sometimes as little as 1%), the return can be outstanding (100%). Sadly, the reverse is equally true and apparently more relevant – without sufficient protection on the downside, OTC leveraged product investors (potentially nine out of every 10 for retail CFDs) experience the double-edged sword of leverage, and get wiped out by ending up owing more than they invested in the product.

If we start with the premise that the vast majority (70-90%) of retail investors lose money on retail CFDs, for example, and don't understand (or are not adequately informed of) the risk of loss involved, then as Quinn Perrott, Owner, TRAction FinTech, assessed in his blog⁵, "one could argue that lowering leverage may not save investors from losing money, it may simply take investors longer to lose the money." FPSB recommends that restrictions on provision of OTC leveraged products to retail investors include strict leverage limits. FPSB also proposes adding restrictions on the qualifications of those providing or advising on retail OTC leveraged products, introducing a fiduciary (client first) level of care to clients.

FPSB understands IOSCO's approach that, "IOSCO member jurisdictions will need to carefully balance the need to ensure robust investor protection while allowing customers who sufficiently understand the products and their risks and are able to bear any associated losses to continue to trade these products ... according to the sophistication and experience

⁵ <https://financefeeds.com/fca-rulings-cfds-lambasted-lowering-leverage-wont-save-clients-losses-says-regulatory-technology-expert-quinn-perrott/>

of the client.” However, classifying an investor as “retail” or “sophisticated retail” based on characteristics such as net worth, investment experience or previous exposure to complex products, may be misleading. A client’s wealth level is not a direct correlation to financial sophistication, nor is a client’s sophistication level necessarily fixed or equivalent across all complex products. FPSB recommends requiring complex product manufacturers and distributors to assess a target market for their retail OTC leveraged products and to take steps to ensure these products are distributed appropriately, reviewing distribution and product performance to ensure it remains appropriate for the retail investor segment being targeted.

Measure 3: Negative balance protection

{This measure would require market intermediaries to limit retail clients’ losses in CFDs and rolling spot forex contracts to their deposited funds or their funds invested for each trade, thereby preventing firms from recovering any losses that exceed the clients’ deposited funds or funds invested for each trade.}

FPSB welcomes the concept embraced by some IOSCO members to “restrict marketing, distribution and sale of CFDs that do not limit the client’s losses to the balance on the client’s trading account.” While FPSB understands that certain trading strategies may be limited or additional costs incurred by the firm, FPSB believes that an appropriate level of consumer protection for retail investors investing in OTC leveraged products calls for negative balance protection on a “per position” basis rather than a “per account” basis. By offering the protection on a “per position basis,” investors with positions in multiple CFDs could be alerted to the failure rate of each position at the earliest opportunity, and have the ability to shut down remaining CFD positions, rather than finding that the overall account of CFDs was valued at zero, with no ability to salvage some of the investments.

Measure 4: Prescribed disclosures setting out the total costs of the product

{This measure would require market intermediaries to provide a standardised disclosure that sets out the total costs and charges charged by intermediaries relating to the product before it is sold to retail clients.}

Measure 5: Disclosure of investor profit and loss ratios

{This measure would require market intermediaries to disclose to their clients the percentage of client accounts that made a net profit or loss during a certain period of trading activity.}

FPSB supports sufficient levels of disclosure to retail clients about the total cost, objectives, target market and performance of OTC leveraged products. However, just as important, the disclosures need to be provided to the retail client in a simple and understandable format, prior to any purchase decision and ongoing, as requested by the client.

As IOSCO notes, “Firms in the sector are commonly observed using misleading marketing messages when promoting their products to retail clients, focusing on the benefits and ease of trading ... and emphasizing the potential of significant profits, while playing down the risks and potential for rapid and potentially unlimited losses.” FPSB proposes that retail OTC leveraged products display a risk warning that is short, comprehensible and unambiguous for all media cautioning investors on the complexity, risk and likelihood of losses.

If investors are fully aware of the failure rate of such investments, and continue to invest in them (after possibly experiencing one large investment return), the content of warnings and disclosures for these products may need to align with research into the cognitive biases that enable gamblers to understand the low probabilities of winning, yet to believe that they may still have a chance to win. Research suggests that effectively communicated knowledge does

not modify irrational beliefs or erroneous estimations of the chances of winning.⁶ IOSCO members might consider developing “self-appraisal messages, which are particularly relevant for gambling as research shows that having accurate knowledge of gambling probabilities and understanding games does not influence gambling behaviour. ... Messages encouraging self-appraisal (e.g., “Have you spent more than you intended?”) had a significantly greater reported effect on thoughts and behaviours than informative messages.”⁷

Measure 6: Adoption of a fair pricing methodology and use of externally verifiable price sources

{This measure would require market intermediaries to be able to demonstrate a clear pricing methodology for the relevant products and to use independent and externally verifiable price sources and liquidity providers to derive their prices.}

Measure 7: Enhanced disclosures about order execution quality

{This measure would require that market intermediaries provide clear and effective disclosures to their clients about how their orders are executed.}

FPSB considers these measures to be reasonable. FPSB would suggest that most retail investors will not understand (nor may they care about) the implications of how their orders are/are not executed.

Measure 8: A ban or restrictions on certain forms of marketing and sales techniques for the relevant products

{This measure would involve placing restrictions on certain forms of marketing or sales techniques used by market intermediaries offering some or all of the relevant products to retail investors.}

FPSB supports the notion that general regulatory requirements applicable to market intermediaries do not sufficiently address some risks arising from some retail OTC leveraged products, and that IOSCO members should consider banning certain products for retail investors or prohibiting certain forms of aggressive sales or marketing techniques. As additional protection, FPSB recommends that IOSCO stipulate that retail investors accessing complex products such as forex contracts, CFDs or BOs have input from competent, ethical financial advisors or financial planners, who put the client’s interests first.

Measure 9: A ban or restriction on the sale and/or distribution of the relevant products by intermediaries

{This measure would prohibit or restrict the sale and/or distribution of some or all of the relevant products to retail investors by market intermediaries, or require transactions on the relevant products to take place on exchanges.}

Consistent with IOSCO’s consultation paper, FPSB supports the prohibition on the marketing, distribution or sale of binary options (BOs) to retail clients.

FPSB recommends that IOSCO expand its intervention measures for retail OTC leveraged products to include an additional measure:

- **Measure 10: Requirement for Intermediaries to Deliver Complex Products to Retail Investors with a Fiduciary-Like/Client Best Interest Level of Care.**

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⁶ Journal of Business Research Optimal Content for Warning Messages to Enhance Consumer Decision Making and Reduce Problem Gambling, www.sciencedirect.com/science/article/pii/S0148296315001216

⁷ Ibid.