22 July 2021

Circular: ESMA Opinion on the product intervention measures relating to turbos proposed by the Dutch Authority for the Financial Markets (AFM)

Background and Scope

National competent authorities (NCAs) may take product intervention measures in accordance with Article 42 of Regulation (EU) No 600/2014. At least one month before a measure is intended to take effect, an NCA must notify all other NCAs and the European Securities and Markets Authority (ESMA) of the details of its proposed measure and the related evidence, unless there is an exceptional case where it is necessary to take urgent action.

In accordance with Article 43 of Regulation (EU) No 600/2014, ESMA performs a facilitation and coordination role in relation to such product intervention measures taken by NCAs. After receiving notification from an NCA of its proposed measure, ESMA must adopt an opinion on whether it is justified and proportionate.

The Dutch Authority for the Financial Markets (AFM) notified ESMA on 25 January 2021 of its intention to take product intervention measures under Article 42 of that Regulation (national measures). The AFM provided further information on the content of its notification on 3 May 2021. The ESMA Opinion on the AFM Product Intervention Decision can be accessed from here: https://www.esma.europa.eu/file/119738/download?token=L7YlwFsH

The national measures consist of a permanent restriction of the marketing, distribution or sale of turbos to retail clients in the Netherlands. In particular, the measures will be as follows: (i) a leverage cap, (ii) a prohibition to provide retail clients with a payment or other prohibited benefits in relation to the marketing, distribution or sale of a turbo, and (iii) the requirement of a risk warning, all by and large in line with existing restrictions already applicable to contracts for differences (CFDs) in the Netherlands and throughout the Union.

Turbos addressed by the national measures are bonds that have a stop-loss feature and whose value is derived from the value of an underlying asset and the financing of the value of the underlying asset, or other debt instruments that have a stop-loss feature and whose value is derived from the value of an underlying asset and the financing of the value of the underlying asset. They are high-risk leveraged products with which investors speculate that the prices of the underlying asset, such as a share, an index or a currency, will rise or fall.

Although turbos are complex products, they are offered to retail clients most commonly on electronic trading platforms, without the provision of investment advice or portfolio management. An assessment of appropriateness is required in such cases pursuant to Article 4:24 of the Dutch Financial Supervision Act (Wet op het financieel toezicht / Wft). Providers are obliged to warn clients if they judge the service or product to be inappropriate. However, this assessment alone does not prevent turbos, without applying restrictions, from ending up with clients for whom they are not appropriate.

Based on the AFM finding that in the Netherlands turbos are very similar to and similarly used by retail clients as CFDs, the AFM is of the view they should also be subject to similar restrictions as CFDs.

For the above reasons, the AFM reached the conclusion that turbos pose significant investor protection concerns in the Netherlands and that, without the national measures, turbos would continue to cause retail clients harm, inter alia, from potentially sudden and unexpected losses.

ESMA's assessment of the national measures' justification and proportionality

In its assessment of the justification and proportionality of the national measures, ESMA has taken into account (i) the reasons provided by the AFM in its notification of the national measures and in subsequent exchanges, as resulting from the ESMA opinion; (ii) the AFM's consultation paper, including the accompanying cost-benefit-analysis and the analysis of data provided on significant losses incurred by Dutch retail clients; (iii) the complexity of turbos; (iv) the lack of transparency in their pricing; and (v) the AFM's assessment of the turbo market in the Netherlands and its evolution.

In ESMA's measures, ESMA acknowledged that turbos, despite differing in various respects from CFDs, also have similarities with CFDs and that ESMA and the NCAs would monitor whether detrimental consequences for retail clients similar to those observed in relation to CFDs would also arise in respect of products with similar or comparable features to CFDs. For the purposes of the national measures, ESMA has assessed the relevance of the AFM's supervisory experience, in particular the evidence concerning the significant losses of Dutch retail clients when investing in turbos and the recent expansion of the turbo retail market in the Netherlands.

Given these national specificities, ESMA considers that the national measures are justified and proportionate.

Target Audience

The national measures explained above are intended to apply both to turbo providers authorised in the Netherlands and to turbo providers authorised in another Member State that provide investment services and/or perform investment activities in the Netherlands by way of a branch or the freedom to provide services.

Turbo providers are (i) investment firms within the meaning of Article 4(1)(1) of Directive 2014/65/EU(6), (ii) credit institutions within the meaning of Article 4(1)(27) of that Directive, when providing investment services and/or performing investment activities, and (iii) market operators within the meaning of Article 4(1)(18) of that Directive, including any trading venues they operate.

Next steps

The AFM informed ESMA that the national measures are expected to take effect no earlier than two months from the date of publication of the ESMA opinion, that is, **7 August 2021**.

We expect licenced Maltese investment firms and licenced credit institutions (providing investment services to Dutch retail clients) to establish whether turbos form part of their existing and/or future financial product offerings to retail investors. In the affirmative, the Investment Firm/Credit Institution would be expected to apply the referred restrictive measures to Dutch retail clients from 7th August onwards, whether the referred clients are being serviced on a cross-border basis and/or through the establishment of a branch in the Netherlands.

It is not excluded that the implementation of the above measures may come under scrutiny during future on-site inspections.

Contacts

Should you have any queries regarding the above, please do not hesitate to contact: csuinvestments@mfsa.com.mt