



FINANTSINSPEKTSIOON

Trading based on derivative securities – an activity requiring investment services licence

Estonian Financial Supervision Authority (hereinafter EFSA) considers that trading based on rolling spot forex contracts, contracts for difference, binary options and other similar instruments based on underlying assets such as precious metals, shares, currencies, indices etc is by its nature an investment service and therefore comes under the Estonian Securities Market Act (hereinafter SMA).¹ Hence the provision of the abovementioned services requires authorisation for investment services pursuant to the investment services mentioned in Article 43(1) points 1 and 2 of SMA. Such a licence for Estonian entities shall be granted by EFSA.

EFSA further explains the characteristics of some of the aforementioned contracts. For instance, a rolling spot forex contract can be indefinitely renewed with no currency actually delivered or handed over as is common for currency exchange. This exposes both parties to fluctuations in the underlying currency rates. A rolling spot forex exchange contract is considered as a derivative contract. Depending on its qualities, the contract either falls under a futures contract pursuant to Article 2(11) point 1 of SMA (Annex I section C point 4 of MiFID²) or a contract for difference pursuant to Article 2(11) point 6 of SMA (Annex I section C point 9 of MiFID). The gains or losses of such contracts are assessed by the changes in the market price of the currency pair. The calculation of a rolling spot forex contract value is based on the exchange rates of the currencies included in currency pairs or baskets of currencies.

Contracts for difference are securities pursuant to Article 2(11) point 6 of SMA (Annex I section C point 9 of MiFID). These contracts may also be referred to as financial contracts for difference which are contracts for difference in relation to MiFID financial instruments, including currencies, interest rates or other financial indices.³ A contract for difference in the form of a credit derivative contract is covered by Article 2(11) point 2 of SMA (Annex I section C point 5 of MiFID). Contracts for difference in relation to other underlying assets such as climatic variables, freight rates, emission allowances etc are covered by Article 2(11) point 7 of SMA (Annex I section C point 10 of MiFID).

Binary options that are being used for trading currency pairs and are settled in cash, classify as derivative contracts and securities within the meaning of SMA. Depending on the type of underlying assets, such options may fall under derivative contracts listed in Article 2(11) points 1, 2, 3 or 4 of SMA (Annex I section C points 5, 6 or 7 of MiFID).

For additional information, please consult with the European Commission Regulation (EC) No 1287/2006. In particular, Articles 37 and 38 provide further specification on derivative instruments.

¹ SMA available in English at: <https://www.riigiteataja.ee/en/eli/523112015001/consolide>.

² 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 repealing Council Directive 93/22/EEC.

³ Questions on Single Market Legislation ID 359. Available at: <http://ec.europa.eu/ygol/index.cfm?fuseaction=question.show&questionId=359>.