

# Product intervention measures for retail binary options

**Consultation Paper**

CP18/37\*\*

December 2018



## How to respond

We are asking for comments on this Consultation Paper (CP) by 7 February 2019.

You can send them to us using the form on our website at: [www.fca.org.uk/cp18-37-response-form](http://www.fca.org.uk/cp18-37-response-form)

**Or in writing to:**

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Financial Conduct Authority  
12 Endeavour Square  
Stratford London E20 1JN

**Telephone:**

020 7066 1000

**Email:**

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**How to navigate this document onscreen**

returns you to the contents list



takes you to helpful abbreviations

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# 1 Summary

## Why we are consulting

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- 1.1** Binary options or binary bets<sup>1</sup> are financial products that involve an investor 'betting' on whether an event will happen or not. For example, whether the price of a share, currency, commodity, or an index will go up or down within a certain timeframe. The potential outcome is predetermined, with an investor<sup>2</sup> usually losing their initial stake if their prediction is incorrect, or receiving a fixed pay-out if they are correct. In some cases, binary options may have more than two outcomes, but these remain pre-determined. Binary options are treated as a subset of contracts for difference products (CFDs).
- 1.2** Retail consumers<sup>3</sup> use binary options primarily for speculative purposes. Firms offering these products act as the direct counterparty to the client and, as such, usually benefit from client losses.
- 1.3** In recent years, binary options have been widely marketed to retail consumers<sup>4</sup> by firms across the European Union (EU). Online advertising, social media and blogs have often been used to aggressively sell these products and exaggerate the potential for profits. This is misleading as retail consumers are most likely to sustain a loss.
- 1.4** We have significant concerns about investor protection from the sale of binary options to UK retail consumers. This is based on evidence of aggressive and/or misleading marketing of these products, their inherent complexity and lack of transparency, and the level (and speed) of retail consumer losses experienced when trading binary options.
- 1.5** Due to EU-wide concerns about investor protection in relation to these products, the European Securities and Markets Authority (ESMA) introduced a temporary EU-wide product intervention measure<sup>5</sup> to ban investment firms from marketing, distributing or selling binary options to retail consumers. The ban applied from 2 July 2018 for an initial 3-month period. The FCA supported ESMA's approach. The ban has since been renewed twice<sup>6</sup>, but has been amended to exclude 'securitised binary options' (defined by ESMA as binary options that are listed on a formal trading venue, are subject to a prospectus, and have minimum contract periods from the point of entry to the expiry of the binary option).

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1 To qualify as binary or other fixed outcome bet, a product must meet the conditions listed in Article 85(4A) and (4B) of the Regulated Activities Order (RAO) and as described in PERG 2.6.24A.

2 Most investors in binary products are retail consumers.

3 References to retail consumers should be read as including references to retail clients according to COBS 3.4.

4 In this CP we use the term retail client when discussing how the intervention measures will be applied under our proposals, or how they are applied under ESMA's intervention.

5 ESMA's first product intervention decisions in relation to contracts for differences and binary options is available here: [www.esma.europa.eu/sites/default/files/library/esma35-1135\\_notice\\_of\\_pi\\_decisions\\_on\\_cfds\\_and\\_binary\\_options.pdf](http://www.esma.europa.eu/sites/default/files/library/esma35-1135_notice_of_pi_decisions_on_cfds_and_binary_options.pdf)

6 ESMA's product intervention renewal decision of August 2018 in relation to binary options is available here: [www.esma.europa.eu/sites/default/files/library/2018-esma35-43-1391\\_bo\\_renewal\\_decision\\_notice\\_en.pdf](http://www.esma.europa.eu/sites/default/files/library/2018-esma35-43-1391_bo_renewal_decision_notice_en.pdf); ESMA's second renewal decision of November 2018 is available here: [www.esma.europa.eu/press-news/esma-news/esma-renews-binary-options-prohibition-further-three-months-2-january-2019](http://www.esma.europa.eu/press-news/esma-news/esma-renews-binary-options-prohibition-further-three-months-2-january-2019)



- 1.6** To address harm to retail consumers, this Consultation Paper (CP) is proposing rules in the FCA Handbook to prohibit the sale, marketing and distribution of binary options to consumers treated as retail clients by firms that carry out activity in, or from, the UK. Our proposal applies a permanent prohibition to replace ESMA's temporary intervention measure.
- 1.7** Today, on 7 December 2018, we have also published a separate CP proposing permanent rules for firms offering other types of CFD products to retail consumers.<sup>7</sup>

### Who this applies to

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- 1.8** Our proposals will primarily affect:
- retail clients or prospective retail clients who invest in binary options
  - UK MiFID investment firms and EEA MiFID investment firms, including Capital Requirements Directive (CRD) credit institutions as appropriate, marketing, distributing or selling binary options in, or from, the UK to retail clients
  - UK branches of third country investment firms marketing, distributing or selling binary options
- 1.9** Our proposals may also be of interest to:
- consumer bodies
  - current and prospective retail clients who invest in binary options

### The wider context of this consultation

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- 1.10** The significant concerns about the risks to investors posed by binary options have made them a focus of both EU and international initiatives in recent years. These initiatives have informed the domestic policy proposals set out in this CP.
- 1.11** Following ESMA's prohibition of the sale, marketing and distribution of binary options to retail consumers, the [FCA announced its intention to consult](#) on whether to apply these measures on a permanent basis domestically. This CP sets out that consultation.
- 1.12** The wider international and domestic context is explained in Chapter 2.

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<sup>7</sup> [www.fca.org.uk/publication/consultation/cp18-38.pdf](http://www.fca.org.uk/publication/consultation/cp18-38.pdf)

## What we want to change

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- 1.13** We are proposing to prohibit the sale, marketing and distribution of binary options in, or from, the UK, to retail consumers, by creating new rules in our Conduct of Business Sourcebook.
- 1.14** Our approach reflects the scope of the initial intervention measures introduced by ESMA on 2 July 2018. Therefore we propose to also include under our prohibition certain types of binary options which ESMA decided to exempt from its renewal of measures on 2 October 2018.
- 1.15** In particular, our domestic prohibition will cover 'securitised binary options' as defined and exempted by ESMA. We believe that these products have a similar, binary pay-off structure and are just as difficult for retail consumers to value as other types of binary options, and so raise similar, significant concerns about investor protection. These binary options also present possible means of arbitrage for firms seeking to avoid the prohibition by manufacturing alternative binary products.
- 1.16** We discuss our proposals in Chapter 3.

## Outcome we are seeking

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- 1.17** We want to permanently prohibit the sale, marketing and distribution of binary options in, or from, the UK to retail consumers. This will reduce harm to retail consumers.

## Next steps

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### How to respond to our consultation

- 1.18** We are asking for feedback by 7 February 2019. Use the online response form on our website: [www.fca.org.uk/cp18-37-response-form](http://www.fca.org.uk/cp18-37-response-form) or write to us at the address on page 2.

### What we will do next

- 1.19** We will consider feedback on our proposals and aim to publish a Policy Statement (PS) and final Handbook rules by March 2019.
- 1.20** In the meantime, firms will need to continue to comply with the ESMA intervention measures as directly applicable provisions for as long as ESMA's decision notice is in force in the UK.



## Implications of EU withdrawal

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- 1.21** In March 2018, the UK and the EU reached agreement on the terms of an implementation (or transitional) period following the UK's withdrawal from the EU.
- 1.22** The implementation period is intended to operate from 29 March 2019 until at least the end of December 2020. During this time, EU law would remain applicable in the United Kingdom, in accordance with the overall withdrawal agreement. Firms, funds and trading venues would continue to benefit from passporting between the UK and EEA as they do today. Obligations derived from EU law would continue to apply and firms must continue with implementation plans for EU legislation that is still to come into effect before the end of December 2020.
- 1.23** The implementation period forms part of the withdrawal agreement, which is still subject to ratification. We continue to work to ensure the UK's legal and regulatory framework for financial markets would also function in the absence of a withdrawal agreement or implementation period. To do so, if EU law no longer applies, and we are unable to finalise rules by 29 March 2019, we will likely adopt temporary, emergency product intervention measures to replicate ESMA's temporary intervention.
- 1.24** These measures would ensure that there is no loss of consumer protections between ESMA's existing interventions ceasing to have effect in the UK, and finalising our domestic approach.

## 2 The wider context

- 2.1** This chapter describes the domestic and international policy developments for binary options. We also discuss the UK binary option market and our concerns about investor protections in this market.

### Domestic policy developments

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- 2.2** In the UK, binary options were historically treated as gambling products and, as such, were licensed by the UK Gambling Commission and were not subject to FCA regulation.
- 2.3** HM Treasury consulted on, and concluded, that binary options were to be brought within the scope of FCA regulation as part of the transposition of MiFID II. This followed an earlier European Commission opinion suggesting that they should be considered as MiFID financial instruments. The RAO was amended to bring binary options inside our regulatory perimeter, and since 3 January 2018 UK firms offering those binary options have been required to be authorised by the FCA.

### Discussion on binary options in CP16/40

- 2.4** On 6 December 2016, we outlined our early policy considerations for the sale and distribution of binary options to retail consumers in a Discussion Chapter within [CP 16/40: Enhancing conduct of business rules for firms providing contract for difference products to retail consumers](#).
- 2.5** CP16/40 highlighted our significant concerns about risks to retail consumers that stem from the inherent product features of retail binary options, the risks from the conduct of incoming EEA firms and the rise in scams linked to these products.
- 2.6** We also discussed a range of possible policy proposals, including a possible ban on the sale of binary options to retail consumers. We concluded that binary options:
- did not allow retail investors to make informed decisions. This is because it is nearly impossible to predict outcomes in such short periods, and the short maturities of these products can also lead to addictive behaviour akin to gambling
  - involve significant information asymmetries for consumers. Pay-outs are linked to probability theory rather than directly correlated to a public reference price
  - lead to inherent conflicts of interest for the firm which takes the other side of the client's bet
- 2.7** We invited views from market participants on the risks we identified, what investment need binary options served for retail consumers, and the potential policy measures we could consider based on forthcoming Markets in Financial Instruments Regulation (MiFIR) product intervention powers.



- 2.8** As we are now formally consulting on this topic, we have not issued a separate feedback statement to the discussion questions raised in CP16/40. However, we considered carefully all the responses to CP 16/40 and used them to inform our views in discussions at ESMA. The feedback has also informed the approach proposed in this CP. Feedback that we received from the CP16/40 is summarised below.
- 2.9** We received 2,278 responses to CP16/40. Most respondents agreed that we should use product intervention powers for binary options and agreed with the risks we identified, in particular that binary options:
- are inherently prone to information asymmetry, which makes it difficult for retail consumers to judge the value of their investment
  - have features that incentivise firms to act against consumers' interests and that make it difficult for the FCA to verify that the firms offering them are meeting their best execution obligations
  - are unlikely to satisfy a genuine investment need due to the short maturities of the bets, which might encourage addictive behaviour in vulnerable consumers
- 2.10** Respondents also agreed that the behaviour of providers of binary options has resulted in harm to retail consumers.
- 2.11** In light of the identified risks, some respondents argued that all marketing of such products should be banned to all classes of consumers. Others preferred more limited restrictions to the sale, marketing and distribution of these products.
- 2.12** However, some respondents disagreed with the need for product intervention measures and argued that:
- an appropriate way to protect retail consumers would be to create an exchange for binary options to help address concerns around conflicts of interest
  - MiFID II product governance rules would provide adequate protection against the wide-spread poor practice in the binary options sector
  - policy measures should focus on the marketing and sales process (for example, appropriateness test for consumers prior to opening an account) rather than on the product itself
- 2.13** Finally, some respondents differentiated between types of binary options and argued that certain binary options products (for example, 50/50 propositions that could be described as a simple coin toss and that are frequently sold by offshore unauthorised entities) are more likely to cause consumer harm than others. Those respondents favoured a complete marketing ban for certain variants of binary options (for example, for 50/50 products and for those with less than 5 minutes duration).



## Our response

In response to feedback to CP16/40, we updated our [ScamSmart webpages](#) to raise awareness on binary options scams and issued a [consumer warning](#) outlining our concerns.

As previously mentioned, after promoting supervisory convergence through a number of non-binding actions, during 2018 ESMA used its temporary product intervention powers to ban firms from selling binary options (with certain exemptions) to retail consumers across the EU.

In March 2018, we [publicly committed to consult](#) on whether to apply these measures on a permanent basis to firms selling, marketing or distributing binary options in, or from, the UK to retail consumers. Our proposals are discussed in Chapter 3.

## International policy initiatives

- 2.14** There has been a focus on binary options in both the EU and internationally in recent years. This work has informed our domestic policy proposals.
- 2.15** **EU-wide policy developments - ESMA product intervention measures**  
In parallel to our concerns domestically, ESMA and other national competent authorities (NCAs) observed a rapid increase in the marketing, distribution and sale of binary options to retail consumers across the EU.
- 2.16** ESMA and NCAs have also observed an increase in aggressive marketing techniques targeted at retail clients, as well as a lack of transparent information being provided to them. We believe this makes it unlikely that retail clients can easily understand the inherent risks of these products. ESMA and NCAs have expressed widespread concerns on the increasing number of retail clients trading in these products and losing their money. These concerns are also supported by the numerous complaints received from retail clients across the EU who have suffered significant detriment when trading binary options.<sup>8</sup>
- 2.17** As a result, binary options have been a priority of ESMA's supervisory work in recent years. ESMA coordinated a task force composed of NCAs to monitor the offer of binary options and CFDs to the retail mass market as well as to foster uniform supervisory approaches in this area across the EU by publishing a number of [Questions and Answers \(Q&A\)](#) documents in respect of firms offering binary options to retail consumers. [ESMA also published warnings](#), highlighting its concerns about the risks posed by the offering of binary options by unauthorised entities to retail consumers.
- 2.18** Due to ongoing concerns about risks to retail consumers, and the limited success of supervisory convergence tools, ESMA considered applying product intervention measures. ESMA published their proposal to prohibit binary options to retail consumers in a [Call for Evidence](#) on 18 January 2018. Following feedback, ESMA

<sup>8</sup> ESMA Decision Notice of June 2018 in relation to binary options (available here: [https://eur-lex.europa.eu/legal-content/EN/TXT/?uri=uriserv:OJ.L\\_.2018.136.01.0031.01.ENG&toc=OJ.L:2018:136:TOC](https://eur-lex.europa.eu/legal-content/EN/TXT/?uri=uriserv:OJ.L_.2018.136.01.0031.01.ENG&toc=OJ.L:2018:136:TOC)) discusses the size of potential detrimental consequences and the degree of disparity between returns for investors and the risk of loss.



introduced a temporary prohibition on the marketing, distribution or sale of binary options to retail consumers, from 2 July 2018. ESMA renewed the prohibition twice.<sup>9</sup>

### **IOSCO initiatives**

- 2.19** In September 2018, the International Organization of Securities Commissions (IOSCO) published a report on Retail over-the-counter (OTC) Leveraged Products (the 'Report'), including binary options. This Report provides measures for securities regulators to consider when addressing the risks arising from the marketing and sale of OTC leveraged products to retail consumers, including prohibiting their sale and / or distribution.

## **The harm we are trying to address**

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- 2.20** This section discusses the risk of harm binary options pose to retail consumers and the wide-spread scams perpetrated by unauthorised entities, to the detriment of retail consumers.

### **Key features of binary options**

- 2.21** The inherent features of binary options make them inappropriate for many retail consumers. As detailed below and explained further in Chapter 3, binary options pose issues in relation to information asymmetries, conflicts of interest and can induce addictive behaviours akin to gambling.<sup>10</sup>
- 2.22** The pricing structure for binary options can be complex. Methodologies to calculate pay-outs lack transparency and are linked to probability theory rather than directly correlated to a public reference price. In addition, due to the application of spreads and other transaction fees, retail consumers would need significantly to outperform expected returns on investment ('beat the odds') on a regular basis to achieve any profits from trading binary options.
- 2.23** It is often difficult for retail consumers to value these investment products and assess the rate of return relative to the risk of loss. Binary options are typically very short-term investments, in some cases expiring minutes after being entered into, which make them extremely speculative in nature. For example, '30 second countdown' binaries encourage retail consumers to take positions on the movement of prices over a very short timeframe. The short duration of these binary options suggest that they are more like gambling products – and can promote similarly addictive behaviours – rather than being investment products that meet a genuine investment need.
- 2.24** These products also present similar challenges to our ability to ensure that firms are complying with their best executions obligation. These products have an inherent conflict of interest for firms because the firm profits when the client loses their bet.

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9 with the exception of 'securitised binary options'. ESMA's product intervention renewal decision of August 2018 in relation to binary options is available here: [www.esma.europa.eu/sites/default/files/library/2018-esma35-43-1391\\_bo\\_renewal\\_decision\\_notice\\_en.pdf](http://www.esma.europa.eu/sites/default/files/library/2018-esma35-43-1391_bo_renewal_decision_notice_en.pdf); ESMA's second renewal decision of November 2018 is available here: [www.esma.europa.eu/press-news/esma-news/esma-renews-binary-options-prohibition-further-three-months-2-january-2019](http://www.esma.europa.eu/press-news/esma-news/esma-renews-binary-options-prohibition-further-three-months-2-january-2019)

10 As also outlined in: i) our previous CP 16/40 [www.fca.org.uk/publications/consultation-papers/cp16-40-enhancing-conduct-firms-contract-difference-products-retail-clients](http://www.fca.org.uk/publications/consultation-papers/cp16-40-enhancing-conduct-firms-contract-difference-products-retail-clients), ii) ESMA's first product intervention decision in relation to contracts for differences and binary options: [www.esma.europa.eu/sites/default/files/library/esma35-1135\\_notice\\_of\\_pi\\_decisions\\_on\\_cfds\\_and\\_binary\\_options.pdf](http://www.esma.europa.eu/sites/default/files/library/esma35-1135_notice_of_pi_decisions_on_cfds_and_binary_options.pdf) and, iii) IOSCO's Report on Retail OTC Leveraged Products: [www.iosco.org/library/pubdocs/pdf/IOSCOPD592.pdf](http://www.iosco.org/library/pubdocs/pdf/IOSCOPD592.pdf)

These products can also create an incentive for the firm to manipulate the reference price to avoid pay-outs to consumers.

### Unauthorised binary option entities

- 2.25** Unauthorised binary option entities have been a significant source of harm to UK retail consumers in recent years.
- 2.26** In January 2018, Action Fraud [reported](#) that £87,410 is lost to binary options fraud every day in the UK. Action Fraud figures show that under 50's are significantly more likely to fall victim to a binary options scam versus other types of investment fraud.
- 2.27** Further, according to the [City of London Police](#), there have been a reported 2,065 victims who lost £59.4m on binary options scams between 2012 and 2017 with each person losing £22,811 on average.
- 2.28** On 3 January 2018, we published a [list of over 90 unauthorised firms](#) that we understood were offering binary options trading to UK retail consumers. Since 3 January 2018, the FCA has:
- received 543 consumer reports of potentially unauthorised binary option entities
  - reviewed all of these reports and noted that the majority were either based overseas, ceased trading under that name or changed their operating model
  - published 53 warnings on individual unauthorised binary option entities that have a clear link to the UK market
  - opened 10 unauthorised business investigations involving binary options that feature a UK presence, some of which are ongoing
- 2.29** Our [ScamSmart campaign](#) educates consumers on how unauthorised binary options firms operate, how to avoid falling victim to a scam and [what to do if you are scammed](#). We encourage UK retail consumers to use these materials and be wary of any individuals, companies, websites or other media purporting to offer binary options.
- 2.30** We believe that our proposal may help reduce instances of fraud and levels of losses over time, alongside the direct benefits of our measures for retail consumers involving regulated activities. In fact, if we make rules banning the sale of binary options to retail consumers by investment firms in or from the UK, it will be clear that such products are not to be sold to retail consumers as this would be a breach of FCA rules. So, our proposals could contribute to marginally reduce the harm caused by fraudulent activities in this market.

## How it links to our objectives

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- 2.31** Consistent with our operational objective to secure an appropriate degree of protection for consumers, we have significant concerns with the inherent information asymmetry and valuation issues relating to binary options and the evidence of widespread misconduct linked to the sale, marketing and distribution of these products. We consider that a permanent prohibition of binary options to retail consumers is necessary and proportionate to address the significant concerns about



the risk to investors from these products and source of harm they pose for UK retail consumers. Chapter 3 outlines our proposed approach, while our full cost benefit analysis is detailed in Annex 2.

## Wider effects of this consultation

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- 2.32** Annex 2 sets out our analysis of benefits and costs to firms and retail consumers arising out of our proposals in more detail.

## Equality and diversity considerations

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- 2.33** We have considered the equality and diversity issues that may arise from our proposals.
- 2.34** Overall, we do not believe that the proposals adversely impact any of the groups with protected characteristics under the Equality Act 2010. But we will continue to consider the equality and diversity implications of the proposals during the consultation period, and will revisit them when publishing the final rules.
- 2.35** In the meantime, we welcome your input to this consultation on this.

## 3 Our policy proposals

- 3.1** This Chapter discusses our proposals for a permanent prohibition of the sale, marketing and distribution of binary options in, or from, the UK to retail consumers.

### Overview

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- 3.2** We are proposing to permanently prohibit the sale, marketing and distribution of all binary options to retail consumers.
- 3.3** These measures will be applied under Article 42 of the Markets in Financial Instruments Regulation (MiFIR).<sup>11</sup> Where our measures go beyond the MiFIR power we will use our rule-making power under the Financial Services and Markets Act 2000 (FSMA).

### Why we are intervening

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- 3.4** We have considered the factors in Article 42 MiFIR. We are intervening to address significant concerns about investor protection in this market.<sup>12</sup> We have considered the risks and complexity associated with these products, the types of consumers that they are sold to including their level of sophistication, the particular product features, the size of consumer losses, the disparity between consumers' expected return and risk of loss, and the impact of fees and charges.<sup>13</sup> We have also considered the existing regulatory requirements applicable to these products, including product governance requirements in our handbook. We concluded that these requirements do not sufficiently address the risks these products present to retail consumers and the significant concerns about investor protection we have because of the inherent product features. For the same reason, we consider that improved supervision or enforcement of existing requirements would not address our significant concerns about investor protection and would not sufficiently address the risk of harm to consumers.<sup>14</sup>
- 3.5** Instead, our proposals will address the significant concerns about investor protection we have and provide a proportionate response to them, taking into account the nature of the concerns, and the effect on investors and market participants. Our measures will target the specific risks from the product and associated product features and the misalignment of incentives between the firm and the consumer.<sup>15</sup>
- 3.6** More specifically, with reference to the criteria the FCA should take into account under Article 21 of the MiFIR Delegated Regulation (2017/567), we consider that:

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11 If the proposed rules are not made until after 29 March 2019 and there is no withdrawal agreement in place, we would expect to make the rules using a combination of our powers under 'the "onshored" version of MiFIR (see [www.gov.uk/government/publications/draft-markets-in-financial-instruments-amendment-eu-exit-regulations-2018](http://www.gov.uk/government/publications/draft-markets-in-financial-instruments-amendment-eu-exit-regulations-2018)), and Financial Services and Markets Act 2000 (FSMA), as appropriate.

12 Article 42(2)(a)(i) of MiFIR.

13 Article 21 (2)(a)(b)(c)(e)(d)(f)(h) of Commission Delegated Regulation (EU) 2017/567

14 Article 42(2)(b)(i) of MiFIR.

15 Article 42(2)(c) of MiFIR.



- i. Binary options are often too complex for retail consumers to calculate performance and fair value of the products, and understand the likelihood of achieving consistent investment returns from trading them.<sup>16</sup>
- ii. Binary options pose a risk of widespread mis-selling to less sophisticated retail consumers because firms can market them as a 'simple' investment product that can lead to significant profits with limited trading experience. This is despite the fact these are often complex derivative products, and evidence shows that most retail consumers lose money trading these products, in aggregate. This is made worse by structures such as short duration contracts (such as 30 second 'countdown' binary options), easy access to trading via mobile phone applications, and third parties that offer binary options 'trading strategies', suggest easy profits and encourage high volumes of trading.<sup>17</sup>
- iii. Information asymmetries inherent in the product's valuation will favour the firm and probability-based pay-out structures make it difficult for retail consumers to properly assess the fair value of binary options and make an informed investment decision. It is unlikely a retail consumer could achieve a sustained positive return from these instruments, while they also fail to serve as a useful risk-management tool (eg as a hedging instrument). And as such there appears to be no clear investment purpose or appropriate target market for selling these products to retail consumers.<sup>18</sup>

**3.7** Similar issues and justifications were also set out in ESMA's Decision Notice supporting its temporary intervention measures.<sup>19</sup>

**3.8** Our proposed prohibition in relation to the sale, marketing and distribution of binary options to retail clients, will reduce the harm to retail consumers caused by these products. We considered that the inherent features of such products make it difficult for retail consumers to make informed decision and this has led to poor outcomes for retail consumers, therefore a prohibition is the proportionate response.<sup>20</sup> In considering the proportionality of our proposals we have also taken into account the nature of the risks to retail consumers, the level of sophistication of the investors concerned, and the likely effect on investors and market participants.<sup>21</sup>

**3.9** We have consulted NCAs in other Member States that might be significantly affected by our proposals. We have concluded our measures do not have a discriminatory effect on services or activities provided from another Member State.<sup>22</sup> We will also comply with the notification requirements under MiFIR.<sup>23</sup> We are consulting on the same measures that apply under ESMA's temporary intervention. We diverge from ESMA's intervention by applying the same prohibition to 'securitised binary options'. The impact of this on firms in other EEA jurisdictions who sell these products will be low due to the currently limited demand from UK retail consumers.

16 Article 21(2)(a) and (f) of the MiFIR Delegated Regulation

17 Article 21(2) (c) and (j) of the MiFIR Delegated Regulation

18 Article 21(2) (h) and (l) of the MiFIR Delegated Regulation

19 ESMA's product intervention original decision in relation to binary options is available here: [https://eur-lex.europa.eu/legal-content/EN/TXT/?uri=uriserv:OJ.L\\_.2018.136.01.0031.01.ENG&toc=OJ:L:2018:136:TOC](https://eur-lex.europa.eu/legal-content/EN/TXT/?uri=uriserv:OJ.L_.2018.136.01.0031.01.ENG&toc=OJ:L:2018:136:TOC); ESMA's renewal decision can be found here: [www.esma.europa.eu/sites/default/files/library/2018-esma35-43-1391\\_bo\\_renewal\\_decision\\_notice\\_en.pdf](http://www.esma.europa.eu/sites/default/files/library/2018-esma35-43-1391_bo_renewal_decision_notice_en.pdf)

20 Article 42(2)(c) of MiFIR.

21 Article 42(2)(c) of MiFIR.

22 Article 42(2)(d)(e) of MiFIR.

23 Article 42(3) of MiFIR

## Our proposals

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- 3.10** We view a general prohibition on the marketing, distribution and sale of binary options to retail consumers as justified. We base this on the actual and prospective harm to retail consumers caused by the inherent features of the product and how it is offered to retail consumers, as set out in Chapter 2.

### Application and scope

- 3.11** The MiFIR intervention powers override the general approach in MiFID II that firms operating on a services passport with no physical presence in a Member State are generally subject to home state regulation.
- 3.12** Before 29 March 2019, when the UK is due to exit the EU, our measures, if in force, will apply to:
- MiFID investment firms and CRD credit institutions doing MiFID business in the UK with a presence (i.e. a head office or a branch) in the UK. They will apply to activity conducted in the UK. They will apply to services within the scope of the rules that are provided from the UK into another jurisdiction
  - EEA MiFID investment firms and CRD credit institutions doing MiFID business using their rights to carry out activities or provide services into the UK using passporting rights. They will apply to activity within scope of the rules conducted in the UK
  - third country investment firms with a branch in the UK carrying out activity in the UK and/or providing services that are within scope of the measures from the UK into another jurisdiction
- 3.13** After 29 March 2019, the position will change if the UK leaves the EU without a withdrawal agreement. If this happens, our intention is to capture these same firms and activities in our rules. We would therefore draft the rules so that they can cover anyone who would have been in one of the categories above immediately before EU withdrawal. We will not re-consult on such amendments to the draft rules. Without a withdrawal agreement, we would expect to make the rules using either a combination of our powers under the 'onshored' version of MiFIR<sup>24</sup>, and Financial Services and Markets Act 2000 (FSMA), as appropriate.

### Products within scope

- 3.14** We propose to make a new rule in COBS setting out this ban (see Appendix 1: draft Handbook instrument). We have chosen not to exclude the products that ESMA has described as 'securitised binary options'. These are binary options that meet the following 3 conditions:
- have a minimum duration of at least 90 days
  - are accompanied by a prospectus approved and available to the public in accordance with the EU Prospectus Directive
  - do not expose the provider to market risk and the provider or any of its group entities disclose all commissions, transaction fees or other related charges

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24 [www.gov.uk/government/publications/draft-markets-in-financial-instruments-amendment-eu-exit-regulations-2018](http://www.gov.uk/government/publications/draft-markets-in-financial-instruments-amendment-eu-exit-regulations-2018)



- 3.15** We accept that 'securitised binary options' have not been as aggressively marketed in the UK as some other types of binary options, and that the comparatively longer duration of these products means that they are less likely to result in compulsive gambling behaviour.
- 3.16** However, our concern is primarily based on the risk of harm to retail consumers posed by the inherent risks of the product (consistent with (i) and (iii) above and as detailed in Chapter 2). We do not believe that the features of 'securitised binary options' sufficiently address these, in particular because:
- being listed and subject to minimum contract periods does not suggest they meet a genuine investment need for retail consumers, such as use for hedging purposes, since they retain a pre-determined binary pay-out structure
  - they remain complex to value for a retail client and subject to information asymmetries, as the manufacturing firm remains better placed to assess the probability of a certain outcome in financial markets than most retail consumers
  - they are unlikely to be profitable over time, since it is highly likely that, post brokerage fees, these products result in a negative expected return
- 3.17** Also, we take the view that, without a broad ban, firms could create and offer new forms of binary option products that encourage short term excessive trading akin to gambling that could be harmful to retail consumers.
- 3.18** We have considered whether to adopt ESMA's exemption and rely on supervisory monitoring and tools to reduce the risk of harm of firms creating new products falling outside the exemption but which carry similar risks of harm. However, we believe this would be less effective than adopting new rules, and more resource intensive for us to oversee. We do not believe 'securitised binary options' are currently offered widely, if at all, to UK retail consumers by firms operating in, or from, the UK. Our proposed rules will ensure this does not change.
- 3.19** On balance, we do not see benefits from permitting 'securitised binary options' that would outweigh the risks and harm to retail consumers from regulatory arbitrage by binary option firms moving to these products. As set out in our CBA (see Annex 2), we estimate the overall benefits of imposing a permanent ban on the sale of binary options to retail consumers as approximately £17m. We expect the costs to UK firms to be limited to familiarising themselves with the regulation given that firms have already ceased offering binary option products to retail consumers due to ESMA's temporary intervention measures. Any profits foregone would be losses avoided by consumers.
- 3.20** Based on our proposal, policy justification and cost benefit analysis, we welcome feedback on the follow question:
- Q1: Do you agree with our proposal to prohibit the sale, marketing and distribution of all binary options by firms in, or from, the UK, to retail consumers? If not, please explain why not.**



## Next steps

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- 3.21** We welcome feedback on this CP by 7 February 2019.
- 3.22** We will consider feedback on our proposals and aim to publish a PS and final Handbook rules by March 2019.



## Annex 1

### Questions in this paper

- Q1:** Do you agree with our proposal to prohibit the sale, marketing and distribution of all binary options by firms in, or from, the UK to retail consumers? If not, please explain why not.

## Annex 2

# Cost benefit analysis

1. This analysis presents estimates of the material impacts of our proposal. We provide monetary values for the impacts where we believe it is reasonably practicable to do so. For others, we provide qualitative estimates of outcomes.
2. We have conducted this cost benefit analysis (CBA) to assess the proportionality of our proposed intervention and its likely effects on retail consumers and market participants, consistent with our obligations under Article 42(2) of MiFIR. MiFIR does not specifically require a CBA.
3. As mentioned in the CP, we rely on our rule-making powers under FSMA in addition to the powers under Article 42 MIFIR. We are required under FSMA to undertake a CBA for any proposed rules. Specifically, section 138I requires us to publish a CBA of proposed rules, defined as 'an analysis of the costs, together with an analysis of the benefits that will arise if the proposed rules are made'. We have therefore undertaken a CBA for that purpose as well.

### Market failure analysis and the proposed remedies

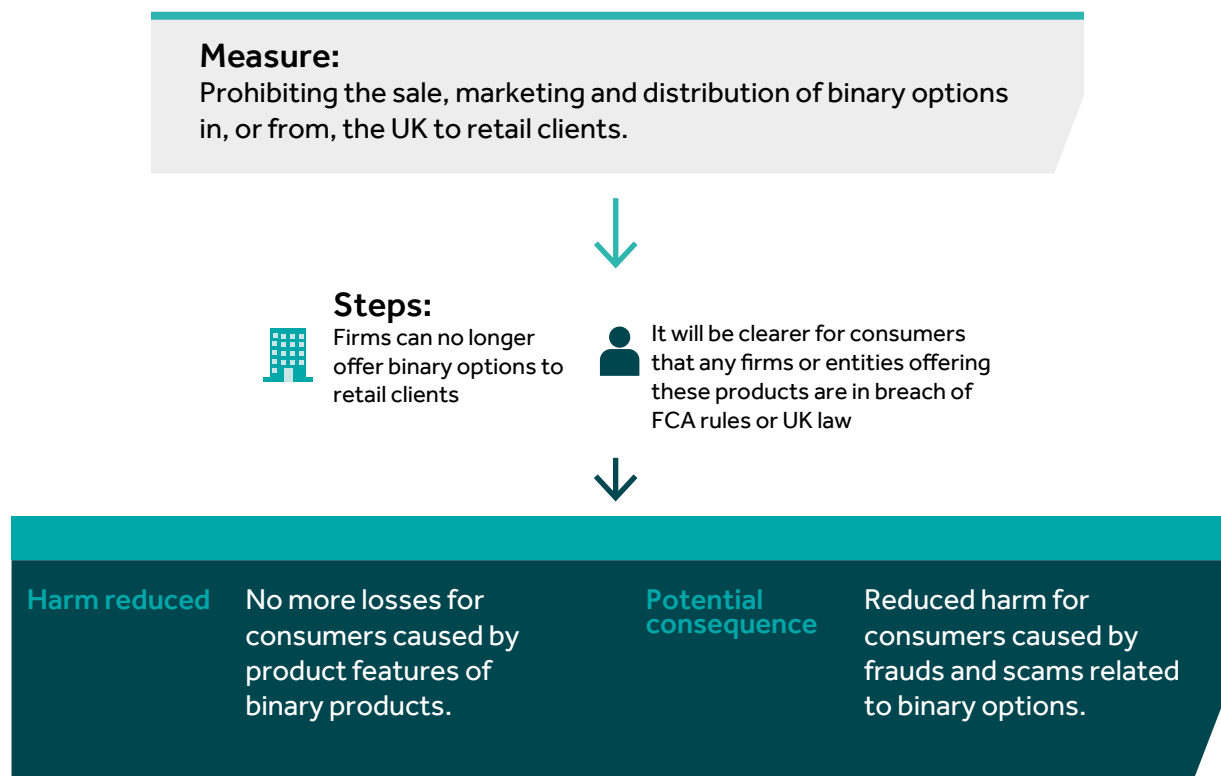
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4. As explained in Chapter 3, binary options are characterised<sup>25</sup> by:
  - information asymmetries which prevent retail consumers from making well informed decisions
  - conflicts of interests which give firms a strong incentive to offer poor odds of positive return and potentially even to manipulate the expiry reference price
  - widespread misconduct (including fraudulent activity<sup>26</sup>) linked to their sale, marketing and distribution
  - short maturity which can lead to addictive behaviour akin to gambling
5. This CP aims to address our significant concerns about the risks to retail consumers in relation to the marketing, sale and distribution of these and guarantee an appropriate level of investor protection. We propose a prohibition on the sale, marketing and distribution of binary options to retail consumers.
6. The diagram below summarises the rationale of our proposal.

25 As also outlined in: i) our previous CP 16/40 [www.fca.org.uk/publications/consultation-papers/cp16-40-enhancing-conduct-firms-contract-difference-products-retail-clients](http://www.fca.org.uk/publications/consultation-papers/cp16-40-enhancing-conduct-firms-contract-difference-products-retail-clients), ii) ESMA's first product intervention decision in relation to contracts for differences and binary options: [www.esma.europa.eu/sites/default/files/library/esma35-1135\\_notice\\_of\\_pi\\_decisions\\_on\\_cfds\\_and\\_binary\\_options.pdf](http://www.esma.europa.eu/sites/default/files/library/esma35-1135_notice_of_pi_decisions_on_cfds_and_binary_options.pdf) and, iii) IOSCO's Report on Retail OTC Leveraged Products: [www.iosco.org/library/pubdocs/pdf/IOSCOPD592.pdf](http://www.iosco.org/library/pubdocs/pdf/IOSCOPD592.pdf)

26 In January 2018, Action Fraud reported that £87,410 is lost to binary options fraud every day in the UK. Further, according to the City of London Police, 2,605 victims lost £59.4m on binary options scams between 2012 and 2017.

**Figure 1: Causal pathway of our proposals and their expected benefits**



7. The sections below assess costs and expected benefits due to the proposal.

## Cost decomposition

### Costs to firms

8. We do not expect any significant one-off costs due to our proposal. ESMA has used its temporary product intervention powers to ban binary options from July 2018. So, firms have already incurred possible one-off costs (for example, one-off compliance costs for closing consumers' accounts or removing marketing materials) due to that prohibition.
9. We do not expect firms to incur any ongoing costs although our proposal to ban binary options will lead to a loss of revenue for binary options providers of circa £17m per year.<sup>27</sup> As discussed below, we estimate ongoing loss of revenues to firms to be equal to benefits to retail consumers, as any profits foregone would be losses avoided by retail consumers.
10. We do not expect any costs to firms due to our decision to include 'securitised binary options' as well as OTC products. These products could not be sold by firms to retail consumers under the ESMA temporary measure from 2 October 2018. There also

<sup>27</sup> During 2018 we requested data from a number of binary options providers in order for ESMA and the FCA to assess the impact of the ESMA product intervention measures. This estimate is based on the sum of retail client account net profits and losses provided by binary options providers, covering January 2018 to June 2018. We obtained the annual figure by doubling the estimated costs based on those six months.

does not appear to have been any retail market for such products in the UK before ESMA's original intervention.

### Costs for consumers

11. By adopting a prohibition, retail consumers will have fewer financial products available on a continuing basis beyond the current ESMA temporary intervention and any subsequent renewal. So, any retail consumers who previously used binary options as a way to hedge some positions would no longer be able to use these products for this purpose. Retail consumers could hedge their positions by using other types of options, which will continue to be available, even if at a higher price. We also take the view that most binary options previously manufactured and distributed are not well suited for hedging purpose since they only provide predetermined, fixed outcomes.
12. Based on the responses to CP16/40, however, we believe that very few retail consumers use these products for hedging purposes. Therefore, costs to retail consumers due to a fewer number of financial products being available are likely to be negligible.

### Benefits we expect to see

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13. Based on our survey, UK retail consumers collectively experience an average loss of around £17m<sup>28</sup> on an annual basis when trading binary options. We expect our proposal to stop this harm.
14. As explained above, benefits to retail consumers are equal to the ongoing loss of revenues to firms as any profits foregone would be losses avoided by consumers.
15. These figures do not distinguish between OTC and 'securitised binary options'. We consider these products have a similar structure and are just as difficult for retail consumers to value as other types of binary options, and so raise similar concerns about investor protection.
16. Additionally, we believe our proposal of a retail client prohibition may also help reduce frauds and scams related to binary options because of the clearer message this gives to retail consumers (e.g. firms should not offer binary options to retail consumers in, or from, the UK).

### Conclusions

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17. Our proposal leads to around £17m direct transfer of wealth from firms to retail consumers who would otherwise be harmed by the offering of binary options and 'securitised binary options'.
18. As such, we believe our proposal is proportionate and justified to deliver our consumer protection objective.

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28 See previous footnote.



## Annex 3

# Compatibility statement

### Compliance with legal requirements

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1. As noted in the CP, we are relying upon our powers under Article 42 of MiFIR to make our product interventions, and to the extent that those interventions are not within the scope of MiFIR we rely upon our rule-making powers under FSMA.
2. When consulting on new rules made under FSMA, the FCA is required by section 138I(2)(d) FSMA to include an explanation of why it believes making the proposed rules is (a) compatible with its general duty, under s. 1B(1) FSMA, so far as reasonably possible, to act in a way which is compatible with its strategic objective and advances one or more of its operational objectives, and (b) its general duty under s. 1B(5) (a) FSMA to have regard to the regulatory principles in s. 3B FSMA. The FCA is also required by s. 138K(2) FSMA to state its opinion on whether the proposed rules will have a significantly different impact on mutual societies as opposed to other authorised persons.
3. This Annex records the FCA's compliance with a number of legal requirements applicable to the proposals in this consultation. It includes an explanation of the FCA's reasons for concluding that our proposals in this consultation are compatible with certain requirements under the Financial Services and Markets Act 2000 (FSMA).
4. This Annex also sets out the FCA's view of how the proposed rules are compatible with the duty on the FCA to discharge its general functions (which include rule-making) in a way which promotes effective competition in the interests of consumers (s. 1B(4)). This duty applies in so far as promoting competition is compatible with advancing the FCA's consumer protection and/or integrity objectives.
5. In addition, this Annex explains how we have considered the recommendations made by the Treasury under s. 1JA FSMA about aspects of the economic policy of Her Majesty's Government to which we should have regard in connection with our general duties.
6. This Annex includes our assessment of the equality and diversity implications of these proposals.
7. Under the Legislative and Regulatory Reform Act 2006 (LRRRA) the FCA is subject to requirements to have regard to a number of high-level 'Principles' in the exercise of some of our regulatory functions and to have regard to a 'Regulators' Code' when determining general policies and principles and giving general guidance (but not when exercising other legislative functions like making rules). This Annex sets out how we have complied with requirements under the LRRRA.

## **The FCA's objectives and regulatory principles: Compatibility statement**

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8. Our proposals contribute to the FCA's operational objective of consumer protection.
9. Our consumer protection objective is to secure an appropriate degree of protection for consumers. In considering what degree of protection may be appropriate we are required to have regard to the 8 matters listed in FSMA s.1C(2)(a)-(h).

### **The differing degrees of risk involved in different kinds of investment or other transaction**

10. In proposing to prohibit the sale, marketing and distribution of binary options to retail clients, we considered that the inherent features of such products make it difficult for retail consumers to make informed decision and this has led to poor outcomes for retail consumers. In the light of the above, and as evidenced in our cost benefits analysis, we believe that an outright ban will reduce the harm to retail consumers caused by these products.

### **The principle that consumers are provided with a level of care that is appropriate given the risk involved in the transaction and capabilities of the consumer and the differing degrees of experience and expertise that consumers may have**

11. As detailed in Chapter 2, binary options are inherently difficult to value due to i) information asymmetries which prevent retail consumers from making well informed decisions and, ii) conflicts of interests which give firms a strong incentive to offer poor odds of positive return and potentially even to manipulate the expiry reference price;
12. We are proposing to limit the scope of these measures to consumers that are treated as retail clients and not to extend their application to consumers treated as professionals on request. This reflects the fact that elective professionals are likely to know and understand the risks, including the significant risk of loss, and are more likely to be capable of bearing potential losses from trading.

### **The needs that consumers may have for the timely provision of information and advice that is accurate and fit for purpose / the general principle that consumers should take responsibility for their decision / the different expectation that consumers may have in relation to different kinds of investment**

13. The information asymmetries and the conflicts of interest associated with binary options affect customer decision-making. This can and has resulted in poor outcomes, so we believe we are justified in proposing to ban these products.

### **Having regard to any information which the consumer financial education body has provided to us in the exercise of consumer financial education function**

14. We have given due regard to this principle, but we not received any information from a consumer financial education body in relation to retail consumers trading binary options.

### **Having regard to any information received from the Financial Ombudsman Service**

15. We have received information from the Financial Ombudsman Service, including information on the number of complaints received and the number of complaints upheld. This information partially reflects poor outcomes for consumers. However, we think that actual harm to consumers is not fully reflected in these numbers and that the size of retail client losses are more indicative of the extent of harm in the UK.
16. We consider these proposals are compatible with the FCA's strategic objective of ensuring that the relevant markets function well because they aim to address



the market failures identified in Chapter 2. For the purposes of the FCA's strategic objective, 'relevant markets' are defined by s. 1F FSMA.

17. In preparing the proposals set out in this consultation, the FCA has had regard to the regulatory principles set out in s. 3B FSMA.

**The need to use our resources in the most efficient and economic way**

18. While we could simply copy ESMA's exemption for 'securitised binary options' and rely on supervisory monitoring and tools to reduce the risk of harm, we believe this will be resource intensive and may be less effective if a number of firms develop such products.

**The principle that a burden or restriction should be proportionate to the benefits**

19. As evidenced in our cost-benefits analysis, our proposal leads to circa £17m direct transfer of wealth from firms to retail consumers who would otherwise be harmed by the offering of binary options.

20. As such, we believe our proposal is therefore proportionate and justified by our objective to protect consumers.

**The desirability of sustainable growth in the economy of the United Kingdom in the medium or long term**

21. The proposed rules for prohibiting all binary options being sold to retail consumers are designed to encourage customers to purchase products that are of benefit to them, rather than products which they do not need or want. We see this as encouraging sustainable growth in the relevant sectors. Retail sales of binary options were not significant revenue sources for UK firms. We expect our approach benefits wider confidence in UK markets and the UK's reputation as having a well-regulated financial sector to attract business, especially given international concerns with binary options products.

**The general principle that consumers should take responsibility for their decisions**

22. The information asymmetries and the conflicts of interest associated with binary options affect customer decision-making. This can and has resulted in poor outcomes, so we believe we are justified in proposing to ban these products.

**The responsibilities of senior management**

23. Senior managers will need to ensure compliance with our proposed rule prohibiting binary options from being sold to retail consumers.

**The desirability of recognising differences in the nature of, and objectives of, businesses carried on by different persons including mutual societies and other kinds of business organisation.**

24. We consider our proposed rules to apply consistently to firms offering these products. There are a limited number of firms conducting business related to binary options. Our rules should not create any disproportionate effects on any individual firms' or persons' activities compared to others.

**The desirability of publishing information relating to persons subject to requirements imposed under FSMA, or requiring them to publish information**

25. Our proposals will not require firms to publish information, including that relating to persons subject to requirements imposed under FSMA.



- 26. The principle that we should exercise our functions as transparently as possible**  
This CP sets out the detail of our concerns, our policy proposals and assessment of the likely costs and benefits, and seeks feedback. This is consistent with the principle of exercising our functions transparently. It also follows an earlier public discussion on these issues in CP16/40 and ESMA's temporary intervention measures, which the FCA has supported.

- 27. Action to minimise the extent to which a business is used for a purpose connected with financial crime**  
In formulating these proposals, the FCA has had regard to the importance of taking action intended to minimise the extent to which it is possible for a business carried on (i) by an authorised person or a recognised investment exchange; or (ii) in contravention of the general prohibition, to be used for a purpose connected with financial crime (as required by s. 1B(5)(b) FSMA). This CP discussed that unauthorised binary option entities have been a significant source of harm to UK consumers in recent years. Our proposals may help to reduce the risk of financial crime linked to the sale, distribution and marketing of such products.

### **Expected effect on mutual societies**

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- 28.** The FCA does not expect the proposals in this paper to have a significantly different impact on mutual societies. Mutual societies do not currently offer binary options products.

### **Compatibility with the duty to promote effective competition in the interests of consumers**

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- 29.** In preparing the proposals as set out in this consultation, we have had regard to the FCA's duty to promote effective competition in the interests of consumers.
- 30.** Our policy proposal seeks to ensure that UK firms compete in the interests of consumers, rather than by lowering conduct standards and/or offering products or services to retail consumers for whom they are inappropriate, and who may suffer detriment as a result.

### **Equality and diversity**

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- 31.** We are required under the Equality Act 2010 to 'have due regard' to the need to eliminate discrimination and to promote equality of opportunity in carrying out our policies, services and functions. As part of this, we conduct an equality impact assessment to ensure that the equality and diversity implications of any new policy proposals are considered.
- 32.** The outcome of the assessment in this case is stated in Chapter 2 of the CP.



## Annex 4

### Abbreviations used in this paper

<b>CFD</b>	Contracts for Difference
<b>CP</b>	Consultation Paper
<b>EEA</b>	European Economic Area
<b>ESMA</b>	European Securities and Markets Authority
<b>EU</b>	European Union
<b>FCA</b>	Financial Conduct Authority
<b>FSMA</b>	Financial Services and Markets Act
<b>IOSCO</b>	International Organization of Securities Commissions
<b>MiFID</b>	Markets in Financial Instruments Directive
<b>MiFIR</b>	Markets in Financial Instruments Regulation
<b>NCA</b>	National Competent Authority
<b>OTC</b>	Over The Counter
<b>PS</b>	Policy Statement
<b>RAO</b>	Regulated Activities Order
<b>UK</b>	United Kingdom

We have developed the policy in this Consultation Paper in the context of the existing UK and EU regulatory framework. The Government has made clear that it will continue to implement and apply EU law until the UK has left the EU. We will keep the proposals under review to assess whether any amendments may be required in the event of changes in the UK regulatory framework in the future.

We make all responses to formal consultation available for public inspection unless the respondent requests otherwise. We will not regard a standard confidentiality statement in an email message as a request for non-disclosure.

Despite this, we may be asked to disclose a confidential response under the Freedom of Information Act 2000. We may consult you if we receive such a request. Any decision we make not to disclose the response is reviewable by the Information Commissioner and the Information Rights Tribunal.

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# Appendix 1

## Draft Handbook text

## CONDUCT OF BUSINESS (BINARY OPTIONS) INSTRUMENT 2019

### Powers exercised

- A. The Financial Conduct Authority makes this instrument in the exercise of the following powers and related provisions in the Financial Services and Markets Act 2000 (“the Act”):
- (1) section 137A (The FCA’s general rules);
  - (2) section 137D (FCA general rules: product intervention);
  - (3) section 137R (Financial promotion rules);
  - (4) section 137T (General supplementary powers); and
  - (5) section 139A (Power of the FCA to give guidance).
- B. The rule-making provisions listed above are specified for the purposes of section 138G(2) (Rule-making instruments) of the Act.
- C. The Financial Conduct Authority also makes the prohibitions contained within this instrument in the exercise of the power under Article 42 (product intervention by competent authorities) of Regulation (EU) No 600/2014 of the European Parliament and of the Council of 15 May 2014 on markets in financial instruments and amending Regulation (EU) No 648/2012.

### Commencement

- D. This instrument comes into force on [*date*].

### Amendments to the Handbook

- E. The Conduct of Business sourcebook (COBS) is amended in accordance with the Annex to this instrument.

### Citation

- F. This instrument may be cited as the Conduct of Business (Binary Options) Instrument 2019

By order of the Board  
[*date*]

## Annex

### Amendments to the Conduct of Business sourcebook (COBS)

[*Editor's Note:* if rules are made after 29 March 2019, when the United Kingdom leaves the Union, and there is no withdrawal agreement, our intention is to capture the same firms and activities as outlined in the application provisions in this instrument. We would therefore re-draft the rules so that they cover anyone who would have been in one of the categories listed in this instrument immediately before EU withdrawal. We will not re-consult on such amendments to the draft rules. Without a withdrawal agreement, we would expect to make the rules using a combination of our powers under the onshored version of the Markets in Financial Instruments Regulation (which is within the draft Markets in Financial Instruments (Amendment) (EU Exit) Regulations 2018, available on HM Treasury's website), and the Act, as appropriate.

The text in this Annex takes account of the changes proposed in CP18/38 'Restricting contract for difference products sold to retail clients and a discussion of other retail derivative products' (December 2018) as if they were made.]

In this Annex, underlining indicates new text and striking through indicates deleted text, unless otherwise stated.

**22            Restrictions on the distribution of certain ~~regulatory capital instruments~~ complex investment products**

...

After COBS 22.4 (Restrictions on the retail marketing, distribution and sale of contracts for differences and similar speculative investments) insert the following new section, COBS 22.5. The text is not underlined.

**22.5            Prohibition on the retail marketing, distribution and sale of derivative contracts of a binary or other fixed outcomes nature**

Application

22.5.1        R     This section applies to:

- (1)    *MiFID investment firms*, with the exception of *collective portfolio management investment firms*; and
- (2)    *branches of third country investment firms*,

in relation to the marketing, distribution or sale of *investments* specified in articles 85(4A) and 85(4B) of the *Regulated Activities Order* in or from the *United Kingdom* to a *retail client*.

- 22.5.2 G *Firms* are reminded that the *Glossary* definition of *MiFID investment firm* includes *CRD credit institutions* when those institutions are providing an *investment service* or *activity*.
- 22.5.3 G For the avoidance of doubt, in *COBS 22.5.1R*, “marketing” includes *communicating* and/or *approving financial promotions*, and “distribution or sale” includes *dealing* or *arranging (bringing about) deals in investments* in relation to *investments* specified in articles 85(4A) and 85(4B) of the *Regulated Activities Order*.

#### Prohibitions

- 22.5.4 R (1) A *firm* must not:
- (a) sell an *investment* specified in articles 85(4A) and 85(4B) of the *Regulated Activities Order* to a *retail client*;
  - (b) distribute an *investment* specified in articles 85(4A) and 85(4B) of the *Regulated Activities Order* to a *retail client*; or
  - (c) market an *investment* specified in articles 85(4A) and 85(4B) of the *Regulated Activities Order* if the marketing is addressed to or disseminated in such a way that it is likely to be received by a *retail client*.
- (2) Marketing includes, but is not limited to, *communicating* and/or *approving financial promotions*.

