

## **Regulator Assessment: Qualifying Regulatory Provisions**

**Title of proposal:** PS19/11: Product intervention measures for retail binary options

**Lead regulator:** FCA

**Date of assessment:** 02/04/2019

**Commencement date:** 02/04/2019

**Origin:** Domestic

**Does this include implementation of a Cutting Red Tape review?** No

**Which areas of the UK will be affected?** Whole of UK

### **Brief outline of proposed new or amended regulatory activity**

In December 2018, we published Consultation paper 18/37 'Product intervention measures for retail binary options'. The CP proposed rules prohibiting the sale, marketing and distribution of binary options, including securitised binary options, to retail consumers (retail clients) by firms that carry out activity in, or from, the UK.

Binary options or binary bets 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 one of two predetermined alternatives, with an investor 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).

Retail consumers 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.

In recent years, binary options have been widely marketed to retail consumers by firms across the European Union (EU). Online advertising, social media and blogs have often been used to sell these products aggressively and exaggerate the potential for profits. This is misleading as retail consumers are most likely to sustain a loss.

Our intervention to prohibit the sale of binary options to retail consumers follows evidence of consumer harm from the inherent risks of these products and the poor conduct of the firms selling them.

The European Securities and Markets Authority (ESMA) had already prohibited the sale of binary option products on a temporary basis since 2 July 2018. It recently extended that restriction to 2 July 2019.

Our rules will apply alongside ESMA's temporary measures. However, our prohibition goes further than ESMA's by capturing all binary options, including 'securitised binary options' as defined by ESMA, which are exempt from their ban. We believe these products pose the same risk of harm. They have a similar binary pay-off structure and are similarly difficult for consumers to value as other types of binary options.

Our Policy Statement, published 29 March summarised the feedback we received and set out our final policy position and Handbook rules that came into force on 2 April 2019.

### **Which type of business will be affected? How many are estimated to be affected?**

Our proposals will directly affect:

- UK MiFID investment firms and EEA MiFID investment firms, including Capital Requirements Directive (CRD) credit institutions as appropriate, who are marketing, distributing or selling binary options in, or from, the UK to retail clients.
- UK Branches of third-country investment firms who are marketing, distributing or selling binary options to retail clients.

We have been advised by the representative Industry body, the UK Structured Products Association that UK firms do not manufacture or issue securitised binary options. Instead they provide supporting services to intra-group entities outside the UK that manufacture securitised binary options for sale elsewhere. Support services include technical legal or tax advice and conduct risk management activities for intra-group entities that issue the product and also book consolidation. Prior to ESMA's interventions, there were 4 CFD firms that manufactured/issued binary options. We have based our costs estimates on these 4 firms as without the introduction of our ban, and if ESMA lifted their intervention, then these 4 firms would start to sell these products again.

In light of the above since there are currently no manufacturers and issuers in the UK, they will not be effected by the proposals but there will be some effect on ancillary services outside the UK.

<b>Price base year</b>	<b>Implementation date</b>	<b>Duration of policy (years)</b>	<b>Business Net Present Value</b>	<b>Net cost to business (EANDCB)</b>	<b>BIT score</b>
2018	2019	10 (indefinite)	-128.8	15.0	74.8

### **Please set out the impact to business clearly with a breakdown of costs and benefits**

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.

We do not expect firms to incur any other ongoing costs over and above the loss of revenue for binary options providers of circa £17m<sup>1</sup> per year. 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.

We do not expect any costs to firms from our decision to include 'securitised binary options' as well as Over the Counter (OTC) products because:

- UK firms that previously sold OTC binary options ceased offering them from June 2018 when ESMA's EU-wide prohibition took effect; and
- No firms currently sell, market or distribute securitised binary options in the UK.

**Please provide any additional information (if required) that may assist the RPC to validate the BIT Score.**

We did not receive any substantive comments on the contents of the CBA. While we have made some refinements to our proposals in our PS, we do not consider that these changes will significantly affect the figures we gave in the CBA. We have therefore concluded that the CBA set out in CP18/37 still applies.

<https://www.fca.org.uk/publication/consultation/cp18-37.pdf>

<https://www.fca.org.uk/publication/policy/ps19-11.pdf>

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<sup>1</sup> This is based on our survey results of average losses suffered by UK retail consumers (see CBA in CP18/37)