

# Product intervention measures for retail binary options

## **Policy Statement**

PS19/11

March 2019

## This relates to

Consultation Paper 18/37  
which is available on our website at  
[www.fca.org.uk/publications](http://www.fca.org.uk/publications)

**Email:**

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# 1 Summary

- 1.1** In December 2018, we published Consultation Paper 18/37 (CP 18/37) Product intervention measures for retail binary options. The CP proposed rules prohibiting the sale, marketing and distribution of binary options to retail consumers (retail clients) by firms that carry out activity in, or from, the UK.
- 1.2** This Policy Statement (PS) summarises the feedback we received to this consultation. We set out our final policy position and Handbook rules that will come into force on 2 April 2019.

## Who this affects

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- 1.3** Our proposals will directly affect:
- retail consumers who invest in binary options, or are thinking about investing in them
  - 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
- 1.4** Our proposals may also be of interest to:
- consumer bodies

## Implications of EU withdrawal

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- 1.5** As we explained in our CP, in the event of the UK leaving the EU without a withdrawal agreement, our approach seeks to ensure that our rules capture the same firms and activities as originally proposed in the CP. We made clear that we would not re-consult on such changes.
- 1.6** If there is not an implementation period and the passporting regime falls away when the UK leaves the EU, EEA firms who currently passport into the UK and wish to continue operating in the UK will be subject to the temporary permissions regime<sup>1</sup> or the financial services contracts regime<sup>2</sup> (which covers supervised run-off firms and contractual run-off firms).

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1 The government has introduced a temporary permissions regime to allow EEA firms which previously passported into the UK to continue operating. If the UK leaves the EU and is not subject to EU law, such firms should notify the FCA that they wish to obtain a temporary permission under the new temporary permissions regime.

2 The government has introduced a Financial Services Contracts Regime to enable firms who do not enter the temporary permissions regime to wind down their UK business in an orderly fashion. EEA firms which have not obtained temporary permission would be subject to the Financial Services Contracts Regime.

- 1.7** In that scenario, we expect that firms within scope of our rules before EU withdrawal will continue to be subject to them after EU withdrawal. Once the UK is no longer subject to EU law, the rules will apply to firms with a temporary permission, supervised run-off firms<sup>3</sup> and will apply to contractual run-off firms.<sup>4</sup> We may update our rules to include guidance or other clarifications about their scope. We would not expect to re-consult on that change.

## The wider context of this policy statement

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- 1.8** 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.
- 1.9** 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.
- 1.10** Our rules will apply alongside ESMA's temporary measures.<sup>5</sup> 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 just as difficult for consumers to value as other types of binary options.

## What are we changing and what outcome are we seeking

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- 1.11** We are permanently prohibiting the sale, marketing and distribution of binary options (including securitised binary options) to retail consumers.

## Summary of feedback and our response

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- 1.12** We received 8 responses to CP18/37. These responses were from firms, trade bodies, retail consumers and National Competent Authorities (NCAs). Respondents largely focused on the scope of activities that are covered by the proposed ban, specifically that we included securitised binary options.
- 1.13** Chapter 2 of this PS summarises stakeholder feedback, outlines our response and contains our final rules. Annex 1 lists the names of non-confidential respondents and Appendix 1 sets out our final rules.

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3 This is a consequence of proposed rules in GEN 2.2 in the General Provisions Sourcebook (see near final rules in FCA PS19/5) and the EEA Passport Rights (Amendments, etc, and Transitional Provisions) (EU Exit) Regulations 2018 as amended by the Financial Services Contracts (Transitional and Saving Provision) (EU Exit) Regulations 2019.

4 This is a consequence of the EEA Passport Rights (Amendments, etc, and Transitional Provisions) (EU Exit) Regulations 2018 as amended by the Financial Services Contracts (Transitional and Saving Provision) (EU Exit) Regulations 2019.

5 ESMA's measures will no longer apply in the UK when the UK is no longer subject to EU law, but the current ESMA decision will then form part of UK law as a result of the European Union (Withdrawal) Act 2018 (until that decision expires). Firms which comply with our new rules will also be in compliance with ESMA's prohibition.

## Equality and diversity considerations

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- 1.14** We have considered the equality and diversity issues that may arise from the proposals in this PS. We did not receive any feedback on these considerations during the consultation process.
- 1.15** Overall, we do not consider that this policy adversely impacts any of the groups with protected characteristics ie age, disability, sex, marriage or civil partnership, pregnancy and maternity, race, religion and belief, sexual orientation and gender reassignment.

## What do you need to do next?

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- 1.16** From 2 April 2019, your firm must immediately cease selling, marketing or distributing all binary options to retail consumers.
- 1.17** If your firm carries out activity in, or from, the UK you will be required to comply with the new rules in our Handbook alongside ESMA's temporary prohibition until it ceases having effect in the UK.<sup>6</sup>
- 1.18** Firms should therefore ensure they continue to comply with ESMA's temporary prohibition, which has been in effect from 2 July 2018. Firms that comply with our new rules will also be in compliance with ESMA's prohibition.
- 1.19** Our new rules also cover other types of binary option (including securitised binary options) that are not covered by the ESMA restriction. Firms should therefore ensure that they do not sell, distribute or market all binary options to retail clients in, or from, the UK. We understand that no firms currently do this.
- 1.20** Firms' permissions should reflect the activities that they undertake. Accordingly, firms that are currently authorised to offer binary options to retail clients should request a Variation of Permission (VoP) to remove this investment type or apply for a requirement to limit their permissions to offer these products to professional clients only as soon as practically possible.

## What we will do next

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- 1.21** We will continue monitoring firms' compliance with this ban.

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<sup>6</sup> ESMA's temporary prohibition on binary options sold to retail clients (including any further renewals) will continue to apply in the UK whilst the UK remains subject to EU law. After that, it will form part of UK law as a result of the EU (Withdrawal) Act 2018 (until the expiry of the current decision). Firms are therefore required to comply with ESMA's Decision Notices until they expire.

## 2 Our response to consultation feedback

- 2.1** In CP18/37, we asked for views on our proposal to prohibit the sale, marketing and distribution of all binary options by firms in, or from, the UK to retail consumers because of concerns about their actual and potential harm.
- 2.2** We received 8 responses to the consultation including from the UK Structured Products Association (UK SPA) (an industry body), NCAs and retail consumers.
- 2.3** Overall, respondents supported our aim to reduce investor harm from binary options. However, some respondents asked:
- *whether there was sufficient evidence of harm to support the ban on securitised binary options*
  - *what activities for selling, marketing and distributing securitised binary options are caught by the ban*
  - *whether we should use less restrictive measures, rather than an outright ban*
  - *us to maintain a consistent approach to securitised binary options across the EU*

### ***Scope of application to securitised binary options***

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- 2.4** In CP18/37, we explained that the prohibition would include products that ESMA has described as 'securitised binary options'. 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. As a result, we believe they raise similar concerns about actual and potential harm to retail investors. If we did not include securitised binary options, this would also allow firms seeking to avoid the ban to find ways of getting around it by manufacturing alternative binary option products.
- Justification to support the retail securitised binary options prohibition***
- 2.5** Some respondents said that including securitised binary options was not supported by evidence of retail consumer harm. They argued that the consultation paper did not show evidence that retail consumers that invest in securitised binary options are exposed to the same risk of harm as other types of binary options. They were concerned that securitised binary options should not be subject to the same measures as over-the-counter (OTC) binary options.
- 2.6** BaFin said that it did not have sufficient evidence of harm in its market to justify a retail ban on securitised binary options. The AMF stated that it received limited complaints from retail consumers trading securitised binary options, which suggests that retail consumers understand how these products function and that there were no major discrepancies between their expectations and the products' performance. The AMF said that this is because they are generally listed, sold with a prospectus, are fully hedged, have a sufficiently long maturity, and are not aggressively marketed to retail consumers. According to their supervisory experience, they are sold by well-established distributors to a relatively stable and limited client-base.

- 2.7** Some respondents, including the UK SPA, said we had not adequately considered how the additional features of securitised binary options (eg being listed) reduced the harms we identified.
- 2.8** Respondents highlighted that securitised binary options typically have a longer duration compared with OTC binary options. They noted that our consultation acknowledged that a longer duration may reduce the likelihood of compulsive gambling behaviour. Respondents also argued that the sale of securitised products was not accompanied by the aggressive marketing practices that our consultation highlighted.
- 2.9** Respondents also said that securitised binary products are issued with an approved prospectus which gives prospective investors sufficient information to make informed investment decisions. They also did not consider securitised binary options to be as complex to value as traditional binary options.

#### **Our response:**

As noted in our CP, we do not believe 'securitised binary options' are currently traded by UK retail consumers, nor are they sold by UK firms. Our proposed ban would ensure that this does not change.

We accept that securitised binary options would, arguably, be less prone to aggressive marketing as some other types of binary options were in the UK. We also agree that the longer duration for 'securitised binary options' may limit the risk of compulsive gambling behaviour.

However, we still consider that the features of binary options pose an inherent risk of harm to retail consumers. So we do not think that the additional features of securitised binary options (eg being sold with a prospectus and traded on a trading venue) sufficiently reduces their potential harm.

Securitised binary options have a pre-determined, binary pay-out structure, are priced similarly to fixed-odds betting products and are unlikely to be profitable to investors over time. They also fail to serve as a useful risk-management tool (eg as a hedging instrument) as the value of the hedge is limited to the fixed pay-out of the binary option.

Overall, we consider that the harm from allowing securitised binary options outweighs any purported benefits. We still consider that the inherent features of securitised binary options present similar risks of harm to retail consumers as binary options. The factors highlighted by respondents (either individually or taken collectively) do not cause us to change this view.

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#### ***Are all securitised products caught by the prohibition?***

- 2.10** The UK SPA asked us to clarify which products are included in the ban. They considered that the definition of binary options would potentially capture products that were not intended to be within scope of our prohibition. Respondents identified three products: "Autocalls", "Structured Notes" and "Inline Warrants".

- 2.11** They had concerns that our proposals would remove ESMA's exemption from the prohibition for those products where the lower of the two predetermined fixed pay-outs to the client is at least equal to the client's payment (ie the retail client's initial investment is not at risk). We understand that these structured products offer a guarantee that investors receive at least their initial investment, including any commissions, transaction fees and other related costs, and potentially their initial investment plus a fixed rate of return if certain events occur (eg the FTSE reaches 7500).
- 2.12** Autocalls and Structured Notes are products where the returns accrued by the client may be a fixed rate if certain circumstances apply or, in other circumstances, vary in line with one or more underlying reference asset(s) or benchmark(s). Client returns therefore depend on how the underlying asset(s) or benchmark(s) perform, and are variable.
- 2.13** Inline Warrants are investment products that provide a fixed payout at expiry, if the price of the asset does not go above or below a certain price. If it does go above or below a certain price then the investor loses their initial investment.

#### **Our response:**

We consider that Autocalls and Structured Notes are not binary options since only one of the outcomes is fixed and the other is variable. This means that outcomes are not binary and are therefore not caught by the ban. However, as both outcomes are fixed for Inline Warrants, we consider they qualify as binary options and therefore are included in the ban.

We do not consider that structured products where the lower of the two pre-determined fixed amounts is at least equal to the total payment made by a retail client qualify as binary options. These are therefore not in scope of our rules. This is because the consumer's initial investment is not at risk and the economic substance of such products is not akin to fixed odds betting.

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#### ***The need to maintain a consistent approach across the EU***

- 2.14** Some respondents highlighted that a consistent EU approach to product interventions is preferable. The AMF stated that harmonising the scope and features of national product intervention measures is necessary for efficient supervision and enforcement across the EU.

#### **Our response:**

As a point of principle we recognise that a consistent approach across the EU is desirable. However, this must be balanced against our assessment of actual and potential harms to our objectives. In this case we believe the actual and potential harm to UK retail consumers is clear. So, as envisaged by Article 42 of MiFIR, we are taking action to permanently prohibit 'the marketing, distribution or sale' of financial instruments for reasons particular to our markets.



### *Which activities are covered by the ban?*

- 2.15** The UK SPA asked us to clarify the scope of the activities caught by our proposed intervention prohibiting the 'sale, marketing and distribution to retail clients'. Some individual firms asked the same question in relation to our specific CP on restricting contract for difference products sold to retail clients (CP 18/38).
- 2.16** As there are parallels between the two sets of proposals we have read across the responses to this CP, where relevant.
- 2.17** The UK SPA subsequently advised us 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 risk book consolidation. They also have UK senior management who have responsibility and oversight for entities outside the UK.

### **Our response:**

The types of services described by the UK SPA (for example, risk management activities) are not within scope of our prohibition. UK firms are permitted to provide such services on an intra-group basis for manufacturers outside the UK. However, we remind firms that this will ultimately depend on the facts of what they are doing, on a case by case basis.

In our CP we set out our draft Instrument. This included draft guidance to the prohibition on the retail marketing, distribution and sale of binary options. This guidance, referred to 'distribution or sales' as 'including dealing or arranging (bringing about) deals in investments in relation to those investments specified in Article 85(4A) and 85(4B) of the Regulated Activities Order'. Following respondents' feedback, we have decided to remove the activity of 'arranging' since not all arranging constitutes sale and distribution. However, some arranging activities will be caught.

A clear example of arranging that would constitute sale and distribution is an intermediary or broker that receives and transmits a retail client's order for execution on a trading venue.

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## **Less restrictive measures**

- 2.18** A few retail consumers recommended alternative measures to the proposed ban. Alternative suggestions included either having a licensing system for approved brokers or a list of regulated 'trusted' brokers in the UK. The UK SPA suggested that we should use anti-avoidance measures supporting a ban on OTC binary options, rather than extending the scope beyond ESMA's intervention.
- 2.19** The AMF stated that the use of product intervention powers is a measure of last resort. They suggested that we should exhaust our supervisory and enforcement tools to apply existing rules as appropriateness test requirements (ensuring that retail consumers do not self-assess their financial knowledge), before preventing firms from selling securitised binary options to retail clients.

### Our response:

We consider that binary options pose an inherent risk of harm to consumers. This is because their pricing structure ensures that most retail clients lose money. They are also not an appropriate hedging tool as they pay out fixed amounts. For these reasons, we consider that existing rules or supervisory and enforcement tools are insufficient to address our concerns about harm to investors.

For similar reasons, we consider that the operation of a licensing or authorisation scheme for securitised binary options would be unworkable and would not achieve our objective of protecting investors.

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## Cost Benefit Analysis

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- 2.20** In CP18/37, we set out our cost benefit analysis (CBA) of our proposed intervention, as required by section 138I(2)(a) of the Financial Services and Markets Act 2000. We did not receive any substantive comments on the contents of the CBA. While we have made some refinements to our proposals in this 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.

# Annex 1

## List of non-confidential respondents

Autorité des Marchés Financiers (AMF)

Bundesanstalt für Finanzdienstleistungsaufsicht (BaFin)

Five retail consumers

UK Structured Products Association (UK SPA)

## Annex 2

### Abbreviations used in this paper

<b>CBA</b>	Cost Benefit Analysis
<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>MiFID</b>	Markets in Financial Instrument 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>UK</b>	United Kingdom

We have developed the policy in this Policy Statement 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.

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# Appendix 1

## Made rules (legal instrument)

## CONDUCT OF BUSINESS (BINARY OPTIONS) INSTRUMENT 2019

### Powers exercised

- A. The Financial Conduct Authority (“the FCA”) 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 2 April 2019.

### 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  
28 March 2019

[*Editor's note:* when the UK leaves the EU, the rules in this instrument are intended to continue to apply to the same firms after Exit as were covered by the rules before Exit. In particular, the rules will automatically apply to temporary permission firms and to supervised run-off firms covered by the financial services contracts regime. They will also apply to contractual run-off firms under the financial services contracts regime. We will consider whether to amend the instrument to provide further guidance or other clarifications about this but do not expect to re-consult on that.]

## Annex

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

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**

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Insert the following new section after COBS 22.3 (Restrictions on the retail distribution of contingent convertible instruments and CoCo funds). The text is not underlined.

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

Application

- 22.4.1 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*.
- 22.4.2 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*.
- 22.4.3 G For the avoidance of doubt, in *COBS 22.4.1R*, “marketing” includes *communicating and/or approving financial promotions*, and “distribution or

sale” includes *dealing* in relation to *investments* specified in articles 85(4A) and 85(4B) of the *Regulated Activities Order*.

#### Prohibitions

- 22.4.4 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*; or
  - (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*.



