

EUROPEAN SECURITIES AND MARKETS AUTHORITY DECISION (EU) 2018/1466**of 21 September 2018****renewing and amending the temporary prohibition in Decision (EU) 2018/795 on the marketing, distribution or sale of binary options to retail clients**

THE EUROPEAN SECURITIES AND MARKETS AUTHORITY BOARD OF SUPERVISORS,

Having regard to the Treaty on the Functioning of the European Union,

Having regard to Regulation (EU) No 1095/2010 of the European Parliament and of the Council of 24 November 2010 establishing a European Supervisory Authority (European Securities and Markets Authority), amending Decision No 716/2009/EC and repealing Commission Decision 2009/77/EC ⁽¹⁾, and in particular Articles 9(5), 43(2) and 44(1) thereof,

Having regard to 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 ⁽²⁾, and in particular Article 40 thereof,

Having regard to Commission Delegated Regulation (EU) 2017/567 of 18 May 2016 supplementing Regulation (EU) No 600/2014 of the European Parliament and of the Council with regard to definitions, transparency, portfolio compression and supervisory measures on product intervention and positions ⁽³⁾, and in particular Article 19 thereof,

Whereas:

1. By Decision (EU) 2018/795 ⁽⁴⁾, the European Securities and Markets Authority (ESMA) prohibited the marketing, distribution or sale of binary options to retail clients with effect from 2 July 2018 for a period of three months.
2. In accordance with Article 40(6) of Regulation (EU) No 600/2014, ESMA must review a temporary product intervention measure at appropriate intervals and at least every three months.
3. ESMA's review of the prohibition on binary options has been informed by, inter alia, a survey amongst national competent authorities ⁽⁵⁾ (NCAs) on the practical application and impact of the product intervention measure as well as additional information provided by NCAs and stakeholders.
4. NCAs detected only limited examples of non-compliance with the ESMA product intervention measures. Furthermore, no new authorisations have been provided to firms that market, distribute or sell binary options since the announcement of the agreed measures on 27 March 2018.
5. NCAs reported a slight increase in the number of clients treated as professional clients on request over the month of July 2018 in comparison with July 2017. However, the number of professional clients on request is relatively small in comparison to the previous number of retail clients of providers of binary options. ESMA is aware that some third-country firms are actively approaching Union clients. However, without authorisation or registration in the Union, these firms are only allowed to offer services to clients established or situated in the Union at the client's own exclusive initiative. ESMA is also aware that firms are starting to provide other speculative investment products. ESMA will continue to monitor the offer of these other products to determine whether any other Union measures are appropriate.

⁽¹⁾ OJ L 331, 15.12.2010, p. 84.

⁽²⁾ OJ L 173, 12.6.2014, p. 84.

⁽³⁾ OJ L 87, 31.3.2017, p. 90.

⁽⁴⁾ European Securities and Markets Authority Decision (EU) 2018/795 of 22 May 2018 to temporarily prohibit the marketing, distribution or sale of binary options to retail clients in the Union in accordance with Article 40 of Regulation (EU) No 600/2014 of the European Parliament and of the Council (OJ L 136, 1.6.2018, p. 31).

⁽⁵⁾ 20 NCAs have responded: Cyprus Securities and Exchange Commission (CY-CySEC), Comisión Nacional del Mercado de Valores (ES — CNMV), Autoriteit Financiële Markten (NL-AFM), Czech National Bank (CZ — CNB), Financial Market Authority (AT — FMA), Finnish Financial Supervisory Authority (FI — FSA), Comissão do Mercado de Valores Mobiliários (PT — CMVM), Malta Financial Services Authority (MT — MFSA), Financial Supervisory Authority (IS — FME), Financial Services and Markets Authority (BE — FSMA), Commissione Nazionale per le Società e la Borsa (IT — Consob), Financial Supervision Commission (BG — FSC), Bundesanstalt für Finanzdienstleistungsaufsicht (DE — BaFin), Autorité des Marchés Financiers (FR — AMF), Magyar Nemzeti Bank (HU — MNB), Financial Conduct Authority (UK — FCA), Commission de Surveillance du Secteur Financier (LU — CSSF), Romanian Financial Supervisory Authority (RO — FSA), Agencija za trg vrednostnih papirjev (SL — SMA), Central Bank of Ireland (IE — CBI).

6. During the review period, ESMA did not obtain evidence contradicting its overall finding of a significant investor protection concern identified in Decision (EU) 2018/795. ESMA has therefore concluded that the significant investor protection concern identified in Decision (EU) 2018/795 would persist if its decision to prohibit the marketing, distribution or sale of binary options to retail clients is not renewed.
7. Since the adoption of that Decision, the applicable existing regulatory requirements under Union law have not changed and continue not to address the threat identified by ESMA. Furthermore, NCAs have not taken action to address the threat or the actions taken do not adequately address the threat. In particular, since the adoption of the Decision, no NCA has adopted its own national product intervention measure under Article 42 of Regulation (EU) No 600/2014 ⁽¹⁾.
8. The renewal of the prohibition set out in Decision (EU) 2018/795 does not have a detrimental effect on the efficiency of financial markets or on investors that is disproportionate to the benefits of the action and does not create a risk of regulatory arbitrage for the same reasons set out in that Decision.
9. If the temporary prohibition is not renewed, ESMA considers it is likely that binary options will again be offered to retail clients and that the same or similar products will return to the market that gave rise to the consumer detriment identified in Decision (EU) 2018/795.
10. In view of these reasons, taken together with the reasons set out in Decision (EU) 2018/795, ESMA has decided to renew the prohibition for a further three-month period to address the significant investor protection concern.
11. In renewing the prohibition, ESMA has taken care to examine whether there is any new evidence relating to specific products within the scope of its measure that should be exempted in the renewed period of application due to their specific features not giving rise to the significant investor protection concern set out in Decision (EU) 2018/795.
12. In this respect, ESMA obtained new information relating to binary options that are sufficiently long-term, are accompanied by a prospectus and are fully hedged by the provider or another entity in the provider's group, are unlikely to give rise to the significant investor protection concern identified in Decision (EU) 2018/795. An example of this kind of binary option is an inline warrant that cumulatively meets these conditions.
13. While the degree of complexity of this specific type of binary option is comparable to that of binary options generally, the minimum term requirement ameliorates the negative effects of complexity and opacity for investors. Investors can more reasonably take an informed view of the market over a period of 90 days or longer from the date when the product was first issued than over the very brief terms characteristic of the wider binary options market that existed prior to the application of Decision (EU) 2018/795. A term of 90 days or longer reduces the scope for frequently-repeated speculative trades that worsen losses and are associated with addictive behaviour.
14. A particular feature of binary options acting as a significant driver of potential detrimental consequences and exacerbating the disparity between returns for investors and the risk of loss is the conflict of interest that exists between many providers of binary options and their clients. However, some firms provide binary options that are fully hedged against market risk throughout their terms. Where such hedging activity relates to the provision of a binary option and is carried out by the provider or by another entity in the provider's group, and if no profit or loss is made on the binary option by any of the group entities other than previously disclosed commissions, transaction fees and related charges, the conflict of interest between the provider and client is significantly reduced. In particular, the net profit derived from the binary option is not substantially determined by whether it pays out or not. Hedged providers are not incentivised to misreport underlying prices or to speculate against the client.
15. Evidence received by ESMA suggests that hedged business models are consistent with binary options offerings with sufficiently long terms, in contrast to unhedged business models characterised by short term offerings. NCAs ⁽²⁾ supervising markets in which long term securitised binary options are provided by hedged

⁽¹⁾ On 4 June 2018, a competent authority of an EEA EFTA State, NO-Finanstilsynet, adopted national product intervention measures that have the same terms and dates of application of ESMA's measures. Furthermore, on 5 July 2018, the Financial Supervisory Authority of Iceland published that it considers the marketing, distribution or sale of binary options to be contrary to proper and sound business procedures and practices in securities trading according to its national law (Article 5 of Act No 108/2007 on Securities Transactions).

⁽²⁾ DE-BaFIN, [FR-AMF (awaiting confirmation)]

providers have confirmed that in respect of such products they have identified no reported cases of significant detriment to individual retail clients. Furthermore, BaFIN has not received any investor complaints in relation to inline warrants.

16. Additionally, and in this context, the requirement that binary options made available to retail investors must be accompanied by a prospectus approved in accordance with Directive 2003/71/EC of the European Parliament and the Council ⁽¹⁾ is intended to ensure a minimum level of transparency around these longer-term products. It ensures that in relation to the marketing, distribution or sale of these products to retail clients, prescribed information on the provider, including its business model and financial statements, and the risks and characteristics of the product, is made available to investors. Furthermore, the prospectus is subject to the scrutiny of the relevant NCA.
17. There is also no product-specific evidence that the marketing and distribution activities in relation to sufficiently long-term binary options with a prospectus and fully hedged by the provider or another entity in the provider's group consist of aggressive marketing practices and misleading communications techniques.
18. While the existence of any one of the criteria alone would not be sufficient to tackle the risk of investor detriment, ESMA has received new evidence during the renewal period that a binary option that benefits from the cumulative effect of an approved prospectus, a sufficiently long term and full hedging by the provider or its group entity is unlikely to give rise to the significant investor protection concern identified in Decision (EU) 2018/795. Accordingly, binary options that fulfill all these three criteria should be explicitly excluded from the scope of the renewal of ESMA's temporary product intervention measure.
19. ESMA will continue to keep these products under review and will act as necessary. In particular, ESMA has considered the risk that the exclusion may be used by a binary option provider to offer products with comparable features to those that raise significant investor protection concerns, for example, by issuing products that incentivise short duration trading behavior by setting the barrier close to the underlying market price at issuance. ESMA and NCAs will monitor whether any new distribution trends develop and will pay particular attention to products that, despite their long terms, are designed to incentivise such short duration trading behavior.
20. During its review, ESMA also obtained information on existing products that at the end of the term have one of two predetermined pay-outs, neither of which is less than the initial investment. The pay-out for this type of binary option could be the higher or the lower one, but in both circumstances the investor would not lose money compared to its total investment in the product. Decision (EU) 2018/795 targets products with the risk that investors face substantial losses in relation to their total investment in the product. Therefore, for reasons of legal certainty, this renewal should explicitly exclude products whose payoff structure does not put the investor's capital at risk.
21. As the proposed measures may, to a limited extent, relate to agricultural commodities derivatives, ESMA has consulted the public bodies competent for the oversight, administration and regulation of physical agricultural markets under Council Regulation (EC) No 1234/2007 ⁽²⁾. None of those bodies has raised any objections to the proposed renewal of the measures.
22. ESMA has notified NCAs of the proposed renewal Decision,

HAS ADOPTED THIS DECISION:

Article 1

Temporary prohibition on binary options in respect of retail clients

1. The marketing, distribution or sale to retail clients of binary options is prohibited.

⁽¹⁾ Directive 2003/71/EC of the European Parliament and of the Council of 4 November 2003 on the prospectus to be published when securities are offered to the public or admitted to trading and amending Directive 2001/34/EC (OJ L 345, 31.12.2003, p. 64).

⁽²⁾ Council Regulation (EC) No 1234/2007 of 22 October 2007 establishing a common organisation of agricultural markets and on specific provisions for certain agricultural products (Single CMO Regulation) (OJ L 299, 16.11.2007, p. 1).

2. For the purposes of paragraph 1, irrespective of whether it is traded on a trading venue, a binary option is a derivative that meets the following conditions:
- (a) it must be settled in cash or may be settled in cash at the option of one of the parties other than by reason of default or other termination event;
 - (b) it only provides for payment at its close-out or expiry;
 - (c) its payment is limited to:
 - (i) a predetermined fixed amount or zero if the underlying of the derivative meets one or more predetermined conditions; and
 - (ii) a predetermined fixed amount or zero if the underlying of the derivative does not meet one or more predetermined conditions.
3. The prohibition in paragraph 1 does not apply to:
- (a) a binary option for which the lower of the two predetermined fixed amounts is at least equal to the total payment made by a retail client for the binary option, including any commission, transaction fees and other related costs;
 - (b) a binary option that meets the following conditions:
 - (i) the term from issuance to maturity is at least 90 calendar days;
 - (ii) a prospectus drawn up and approved in accordance with Directive 2003/71/EC is available to the public; and
 - (iii) the binary option does not expose the provider to market risk throughout the term of the binary option and the provider or any of its group entities do not make a profit or loss from the binary option, other than previously disclosed commission, transaction fees or other related charges.

Article 2

Prohibition of participating in circumvention activities

It shall be prohibited to participate, knowingly and intentionally, in activities the object or effect of which is to circumvent the requirements in Article 1, including by acting as a substitute for the binary option provider.

Article 3

Entry into force and application

1. This Decision enters into force on the day following that of its publication in the *Official Journal of the European Union*.
2. This Decision shall apply from 2 October 2018 for a period of 3 months.

Done at Paris, 21 September 2018.

For the Board of Supervisors

Steven MAIJOR

The Chair
