

OPINION OF THE EUROPEAN SECURITIES AND MARKETS AUTHORITY

of 26 March 2019

on the product intervention measure relating to binary options proposed by the Financial Conduct Authority of the United Kingdom

Having regard to Article 43(2) 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 ⁽¹⁾,

Having regard to Article 44(1) of 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 ⁽²⁾,

THE EUROPEAN SECURITIES AND MARKETS AUTHORITY BOARD OF SUPERVISORS HAS ADOPTED THIS OPINION:

1. Introduction and legal basis

- (1) National competent authorities (NCAs) may take product intervention measures in accordance with Article 42 of Regulation (EU) No 600/2014. At least one month before a measure is intended to take effect, an NCA must notify all other NCAs and the European Securities and Markets Authority (ESMA) of the details of its proposed measure and the related evidence, unless there is an exceptional case where it is necessary to take urgent action.
- (2) In accordance with Article 43 of Regulation (EU) No 600/2014, ESMA performs a facilitation and coordination role in relation to such product intervention measures taken by NCAs. In particular, after receiving notification from an NCA of its proposed measure, ESMA must adopt an opinion on whether it is justified and proportionate. If ESMA considers that the taking of a measure by other NCAs is necessary, it must state this in its opinion.

¹ 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 (OJ L 173, 12.6.2014, p. 84).

² 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 (OJ L 331, 15.12.2010, p. 84).

- (3) The Financial Conduct Authority of the United Kingdom (FCA) notified ESMA on 25 January 2019 of its intention to take a product intervention measure under Article 42 of that Regulation (national measure). Upon request from ESMA, the FCA provided further information on the scope of the national measure and the content of its notification.
- (4) The national measure consists of a permanent prohibition on the marketing, distribution or sale of binary options to retail clients in or from the United Kingdom.
- (5) ESMA has taken product intervention measures prohibiting the marketing, distribution or sale to retail clients of binary options in Decisions (EU) 2018/795 ⁽³⁾, (EU) 2018/1466 ⁽⁴⁾, (EU) 2018/2064 ⁽⁵⁾ and (EU) 2019/509 ⁽⁶⁾.
- (6) The first of these Decisions took effect on 2 July 2018. 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. These measures have been amended once and renewed three times. If they are not renewed again, the currently applicable measure in ESMA Decision (EU) 2019/509 (ESMA's measure) will automatically expire at the end of the day on 1 July 2019.
- (7) The FCA notified ESMA that the national measure is the same as ESMA's measure at national level, with the difference that the national measure will also apply to the binary options referred to in Article 1(3)(b) of ESMA's measure. The national measure is expected to take effect on 2 April 2019.
- (8) The FCA notified ESMA that it has complied with the conditions in Article 42 of Regulation (EU) No 600/2014, including that it has assessed the relevance of all the factors and criteria listed in Article 21 of Commission Delegated Regulation (EU) 2017/567 ⁽⁷⁾ and taken into consideration all those that are relevant. In particular, the FCA notified ESMA that it shares the reasoning given in ESMA's measure on the existence of a significant investor protection concern, as relevant to the United Kingdom and the conditions in Article 42 of Regulation (EU) No 600/2014. More specifically, the FCA indicated that it concluded that:

³ 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).

⁴ 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 (OJ L 245, 1.10.2018, p. 17).

⁵ European Securities and Markets Authority Decision (EU) 2018/2064 of 14 December 2018 renewing and amending the temporary prohibition in Decision (EU) 2018/795 on the marketing, distribution or sale of binary options to retail clients (OJ L 329, 27.12.2018, p. 27).

⁶ European Securities and Markets Authority Decision (EU) 2019/509 of 22 March 2019 renewing the temporary prohibition on the marketing, distribution or sale of binary options to retail clients (OJ L 85, 27.3.2019, P.19).

⁷ 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 (OJ L 87, 31.3.2017, p. 90).

- (a) binary options are often too complex for retail clients to calculate performance and fair value of the products as well as assess the likelihood of achieving consistent investment returns from trading them;
 - (b) binary options pose a risk of widespread mis-selling to retail clients; and
 - (c) information asymmetries between product providers and retail clients make it unlikely a retail client could achieve a sustained positive return while the products also fail to serve as a useful risk-management tool (e.g. as a hedging instrument).
- (9) In respect of the excluded binary options referred to in Article 1(3)(b) of ESMA's measure, the FCA also considers that these products remain complex to value for retail clients, that information asymmetries remain present and that, considering brokerage fees, they are likely to result in a negative expected return. Moreover, the FCA considers that being listed and subject to minimum contract terms does not suggest they meet a genuine investment need, such as a hedging instrument. The FCA has also observed that such products are not widely, if at all, offered to retail clients by product providers operating in, or from, the United Kingdom.
- (10) As noted in Recitals 13 and 29 of ESMA Decision (EU) 2018/795, several NCAs indicated that binary options in general are at risk of attracting compulsive gambling behaviour since they share fundamental features found in gambling products, which are linked with addictive behavior and poor outcomes for consumers. Although the minimum term from issuance to maturity of at least 90 calendar days for a binary option referred to in Article 1(3)(b) of ESMA's measure reduces the scope for frequently repeated speculative trades that worsen losses and are associated with addictive behavior, the FCA is of the view that it does not eliminate the risk of such trading activity developing. Prior to 3 January 2018, binary options in the UK were sold and regulated as gambling products subject to the oversight of the UK Gambling Commission. The FCA therefore considers that UK retail clients, due to the historical national treatment of these products as gambling products, may be more prone to 'betting' behaviours that could increase the risk of losing money when trading binary options, including those referred to in Article 1(3)(b) of ESMA's measure
- (11) Moreover, the FCA has observed that UK providers of contracts for differences (CFDs) produced new products with similar features to CFDs to avoid the application of ESMA's temporary restrictions on CFDs. Also considering the size of the UK market, the FCA considers that excluding the binary options referred to in Article 1(3)(b) of ESMA's measure from its national measure would significantly increase the risk of circumvention by these UK providers, giving an opening to offer some binary options to retail clients which the FCA considers is likely to be used to offer prohibited binary options or other products with similar features.

- (12) The FCA has observed that UK consumers experienced significant harm from unauthorised binary option providers who target vulnerable consumers, including seniors, students, and the unemployed. In particular, 2,065 consumers lost GBP 59.4m, with an average loss of GBP 22,811 on binary options scams between 2012 and 2017. Furthermore, the UK found from a review of firm data reporting client account performance in 2016 that between 81 % and 85 % of client accounts lost money and that, on average, clients made a loss between GBP 400 and GBP 1 200.
- (13) The FCA shares the reasons given in ESMA's measure that the existing applicable regulatory requirements under Union law, which have not changed since the adoption of ESMA's measure, do not address the concern. The FCA also considers that improved supervision or enforcement of the existing requirements would not better address the concern identified. In particular, the FCA informed ESMA that it has taken into account the supervisory and enforcement experiences of other NCAs as referred to in ESMA's measure and that its supervisory practices take into account the relevant guidance provided by ESMA, including the 'Opinion on MiFID practices for firms selling complex products' ⁽⁸⁾, the 'Opinion on structured complex products – good practices for product governance arrangements' ⁽⁹⁾ and the 'Joint Position of the European Supervisory Authorities on manufacturers' product oversight and governance processes' ⁽¹⁰⁾. Nonetheless, the FCA considers that the significant investor protection concern continues to exist.
- (14) The FCA shares the analysis on proportionality in ESMA's measure and, in particular, has concluded that the national measure is proportionate taking into account the nature of the risks identified, the level of sophistication of investors or market participants concerned and the likely effect of the action on investors and market participants. In the case of one-off costs, the FCA considers that, as the national measure is the same as ESMA's measure except for the inclusion of the binary options referred to in Article 1(3)(b) of ESMA's measure, any one-off costs that may be incurred by product providers to comply with the national measure are likely to be minimal. The FCA also expects product providers to incur a loss of revenue of around GBP17m per year.
- (15) In respect of the likely effect of the national measure on retail clients, the FCA considers that they will have fewer financial products available on a continuing basis. However, the FCA considers that very few retail clients use binary options for hedging purposes and that the costs to retail clients overall are likely to be negligible. The FCA has also estimated that the national measure will lead to around GBP17m direct wealth transfer on an annual basis from product providers to retail clients. Furthermore, the FCA indicated that including the excluded binary options referred to in Article 1(3)(b) of

⁸ ESMA/2014/146.

⁹ ESMA/2014/332.

¹⁰ JC-2013-77.

ESMA's measure is proportionate having regard to its national supervisory experience and the limited demand of such products from retail clients in the United Kingdom.

- (16) The FCA considers that the national measure does not have a discriminatory effect on services or activities provided from another Member State as the measure provides for equal treatment of the marketing, distribution or sale of the products regardless of the Member State from which those services or activities are carried out.
- (17) The FCA notified ESMA that it has consulted NCAs in three other Member States ⁽¹¹⁾ that may be significantly affected by its national measure due to the number of providers authorised in those Member States offering the binary options referred to in Article 1(3)(b) of ESMA's measure. The FCA received information from the AMF and BaFin that there was no evidence of detriment to retail clients in their Member States for the excluded binary options, that they had received few consumer complaints and that they do not intend to prohibit the excluded binary options in their forthcoming national measures. The AMF and BaFin consider that the features of the binary options referred to in Article 1(3)(b) of ESMA's measure significantly mitigate the risk of detriment to retail clients. The AMF informed the FCA that, in its view, the FCA should make further use of its existing supervisory and enforcement tools before banning these products and that it is important to maintain a consistent approach across the European Union.
- (18) Following its consultation, the FCA expects that the costs of its national measure for the providers in these Member States are likely to be low. Despite the information provided by the AMF and BaFin, the FCA considers that the risks of detriment for its UK clients outweigh the benefits of permitting the products within the UK. The FCA notified ESMA and the other NCAs of the national measure not less than one month before it is intended to take effect.
- (19) The FCA considers that the national measure does not pose a serious threat to the orderly functioning and integrity of the national physical agricultural market. In particular, the FCA considers that the national measure is the same as ESMA's measure except for the inclusion of the binary options referred to in Article 1(3)(b) of ESMA's measure and that ESMA consulted the national public bodies competent for the oversight, administration and regulation of physical agricultural markets under Council Regulation (EC) No 1234/2007 ⁽¹²⁾. None of those bodies raised any objections to ESMA Decisions (EU) 2018/795, (EU) 2018/1466, (EU) 2018/2064 or (EU) 2019/509.

¹¹ Autorité des marchés financiers (AMF) in France; Bundesanstalt für Finanzdienstleistungsaufsicht (BaFin) in Germany and De Autoriteit Financiële Markten (AFM) in the Netherlands.

¹² 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. Whether the national measure is justified and proportionate

- (20) The significant investor protection concern raised by the offer of binary options to retail clients led to the adoption of ESMA's Decisions (EU) 2018/795, (EU) 2018/1466, (EU) 2018/2064 and (EU) 2019/509. However, ESMA's measures are temporary. According to the information provided by the FCA, the significant investor protection concern raised by these products continues to exist at national level and needs to be addressed on a longer-term basis to avoid the detrimental consequences that would arise from their unrestricted offer to retail clients. As the national measure is the same as ESMA's measure with an additional stricter element, ESMA has taken into account the reasons for ESMA's measure referred to by the FCA as well as the additional information and reasons given by the FCA.
- (21) Unlike ESMA's measure, the national measure would include the excluded binary options referred to in Article 1(3)(b) of ESMA's measure. ESMA's reasons for considering a binary option meeting the cumulative conditions of that exclusion are unlikely to give rise to the significant investor protection concern identified in its measures were first set out in ESMA Decision (EU) 2018/1466. In providing this exclusion, ESMA acknowledged that these products have a comparable degree of complexity as the prohibited binary options. However, ESMA took account of new evidence, including the supervisory experience of the NCAs. For example, the Bundesanstalt für Finanzdienstleistungsaufsicht (BaFin) has not received investor complaints addressing specific issues of those binary options, even though such binary options had previously been available for sale to retail clients in Germany. ESMA continues to keep its measure under review.
- (22) For the purposes of the national measure, ESMA has assessed the relevance of the FCA's supervisory experience, in particular the likelihood of circumvention of the exclusion by UK product providers, as well as the particular position of UK clients which historically traded binary options as gambling products and have experienced significant losses. ESMA considers that the specificities of the national market together with the inherent complexity of the product justifies a stricter treatment in the national measure.

3. Whether the taking of a measure by other competent authorities is necessary

- (23) For the reasons explained in ESMA's measures, the significant investor protection concern raised by the offer of binary options to retail clients is a cross-border issue. As evidenced by practices to date, product providers are able to offer these products through online trading accounts and passport their services throughout the Union. To effectively address the significant investor protection concern and avoid the risk of regulatory arbitrage, it is essential that product providers cannot exploit differences in treatment by NCAs across Member States. On the expiry of ESMA's measure, product providers may again seek to offer such products in or from a Member State that has not taken a measure at least as stringent as ESMA's measure. Therefore, it is essential that NCAs take concerted action to address this risk.

4. Conclusion

(24) In conclusion, ESMA is of the opinion that:

- (a) the national measure is justified and proportionate; and
- (b) it is necessary for the NCAs of other Member States to take product intervention measures that are at least as stringent as ESMA's measure.

This opinion will be published on ESMA's website in accordance with Article 43(2) of Regulation (EU) No 600/2014.

Done at Paris, 26 March 2019

For the Board of Supervisors
Steven Maijor
The Chair