

Product intervention measures for retail binary options

Financial Conduct Authority (FCA)

RPC rating: validated

Description of proposal

Binary options are financial products where an investor bets on whether an event will occur or not. A common example is where an investor bets on whether the value of a share, currency, commodity, or index will go up or down in a given time-period. The outcome of the bet, in terms of the cash or percentage gain, is predetermined, and if an investor is correct, they receive a fixed pay-out and if they are incorrect, they lose their stake. Historically, binary options were considered gambling products and, therefore, licenced by the UK Gambling Commission. As part of the transposition of the Markets in Financial Instruments Directive II (MiFID II), binary options were brought within scope of FCA regulation.

The FCA considers that binary options are characterised by:

- information asymmetries which prevent consumers from making informed purchasing decisions;
- conflicts of interest incentivising firms to offer poor odds of positive return;
- misconduct (including fraudulent activity) linked to their sale, marketing and distribution; and
- short maturity leading to addictive behaviour akin to gambling.

For these reasons, the FCA has implemented a ban on the sale of binary options to retail consumers. Since July 2018, the European Securities and Markets Authority (ESMA) has had in place a temporary ban on the sale of binary options. This measure makes the ban permanent and extends the prohibition to 'securitised binary options¹', currently excluded from the ESMA ban.

Impacts of proposal

The FCA's ban affects:

- UK and EEA MiFID investment firms, including Capital Requirements Directive credit institutions, and UK branches of third-country investment firms

¹ Binary options are defined by the ESMA as those which 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.

who are selling, marketing or distributing binary options in the UK or to UK consumers.

The cost estimates are based on four firms which were the only firms manufacturing or issuing binary options prior to the ESMA ban. The UK Structured Products Association has advised the FCA that no UK firms manufacture, or issue securitised binary options.

As the ESMA ban has been in place since July 2018, the FCA does not estimate any one-off costs related to the measure.

The regulator assumes that the four firms that operated prior to the ESMA ban, would begin trading if it was to be lifted and, therefore, experience a loss of revenue estimated at approximately £17m per year².

Quality of submission

The FCA provides a clear breakdown of the estimated impacts to business, supported by extensive consultation with industry. The RPC especially welcomes the use of data provided by the affected firms in calculating the loss of revenue. The consultation document³, included as a link in the BIT assessment, sets out a clear rationale for the ban, drawing on a solid evidence of base of consumer losses and harms. Furthermore, the RPC notes that in 2016 the FCA consulted on the measure. Some consultees disagreed with the need for strict intervention, and suggested alternative non-regulatory approaches. In response, the FCA attempted to increase awareness of the issue through updating its 'ScamSmart' webpage⁴. The RPC commends the FCA for reacting to consultee feedback, and for trying a non-legislative approach.

The RPC considers the level of analysis proportionate; however, the BIT assessment would benefit from addressing the following points:

- *Clarity*. The FCA could provide more detail on the consultation process and/or provide clearer cross-referencing to specific sections in the consultation document and policy statement.

² The loss of revenue is calculated as the sum of retail client account net profits and losses provided by binary option providers.

³ <https://www.fca.org.uk/publication/consultation/cp18-37.pdf>

⁴ A place where consumers can find out information on different investments or pension opportunities and, therefore, avoid falling prone to scams.

- *Consumer displacement.* The FCA describes clearly which firms, under the regulators ban, will continue to be prohibited from selling binary options. It is possible that consumer who wish to purchase the options continue to do so from firms outside of both the ESMA and FCA regulations, e.g., non-EU branch of a third-country investment firm. The assessment would benefit from a discussion of possible displacement and its impacts on consumer welfare.

Departmental assessment

Classification	Qualifying regulatory provision (IN)
Equivalent annual net direct cost to business (EANDCB)	£15 million
Business net present value	-£128.8 million
Overall net present value	-£128.8 million

RPC assessment

Classification	Qualifying regulatory provision (IN)
EANDCB – RPC validated	£15 million
Business Impact Target (BIT) Score ⁵	£75 million

⁵ For reporting purposes, the RPC validates EANCB and BIT score figures to the nearest £100,000.
