

**POLICY STATEMENT**

**(PS-03-2019)**



**SUBJECT: POLICY STATEMENT ON THE IMPOSITION OF NATIONAL PERMANENT MEASURES  
IN RELATION TO THE MARKETING, DISTRIBUTION AND SALE OF BINARY OPTIONS**

**DATE OF ISSUE: 10 JULY 2019**

## PURPOSE OF THE PUBLICATION

The Cyprus Securities and Exchange Commission, publishes this Policy Statement in order to notify its decision on the imposition of national measures in relation to the marketing, distribution and sale of Binary Options.

Queries in relation to the content of this Policy Statement may be addressed to the Policy Department of the Cyprus Securities and Exchange Commission at [policy@cysec.gov.cy](mailto:policy@cysec.gov.cy).

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## 1. INTRODUCTION

### PURPOSE OF THIS POLICY STATEMENT

- 1.1. The Cyprus Securities and Exchange Commission (“**CySEC**”) has published this Policy Statement on its decision to impose national measures regarding the marketing, distribution and sale of binary options, pursuant to Article 42 of [Regulation \(EU\) No 600/2014](#)<sup>1</sup> (“**MiFIR**”).
- 1.2. The measures imposed by CySEC are aligned with the European Securities and Markets Authority’s (“**ESMA**”) temporary product intervention measures, which first introduced a prohibition on the marketing, distribution or sale of binary options to retail clients in July 2018. The measures proposed by CySEC called the Cyprus National Product Intervention Measures (“**NPIMs**”) render the ESMA temporary intervention measures permanent in relation to the marketing, distribution or sale of Binary options, in or from the Republic of Cyprus.
- 1.3. There has been no activity in binary options in or from the Republic of Cyprus since July 2018 as a consequence of the [ESMA Decision to temporarily prohibit the marketing, distribution or sale of binary options to retail clients in the Union](#)<sup>2</sup> and the renewals thereof (**the “ESMA Decision on Binary Options”**). To this end NPIMs on binary options are entering into force, without any public consultation, by virtue of [Directive DI 87-08](#).

### DEFINITIONS AND APPLICATION

- 1.4. For the purposes of this Policy Statement:

“Binary Option” means 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;

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<sup>1</sup> 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.

<sup>2</sup> 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

- 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.

1.5. Where the meaning of the terms referred to in the previous paragraph or the meaning of other terms mentioned in this Policy Statement, is further clarified in:

- i The ESMA Decision on Binary Options; or
- ii The [ESMA Questions and Answers on ESMA's temporary product intervention measures on the marketing, distribution or sale of CFDs and binary options to retail clients](#), as amended from time to time (**the "ESMA Q&As on Product Intervention"**),

such further clarification is also assigned to these terms.

1.6. Where a topic is clarified in the recitals of the ESMA Decisions on binary options or in the ESMA Q&As on Product Intervention such clarification applies to NPIMs on Binary Options as well.

1.7. Where a term is not otherwise defined, it shall take the meaning provided for in the Investment Services and Activities and Regulated Markets Law of 2017 (**the "Law"**)<sup>3</sup>.

#### **WHO THIS CONCERNS**

1.8. This Policy Statement concerns the entities that market, distribute or sell Binary Options, in or from the Republic of Cyprus, and to retail investors, as further defined in this Policy Statement.

1.9. Investors will also be impacted by this Policy Statement.

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<sup>3</sup> Transposing Directive 2014/65/EU of the European Parliament and of the Council of 15 May 2014 on markets in financial instruments and amending Directive 2002/92/EC and Directive 2011/61/EU, into national Law.

## 2. RATIONALE FOR SUPERVISORY ACTION

### BACKGROUND INFORMATION

- 2.1. Prior to the ESMA Decision on Binary Options, CySEC supervised a number of CIFs engaging in the provision of investment services in Binary Options. CIFs provided their services in the Republic of Cyprus, but also in other Member States or third countries, either on a cross-border basis or through the establishment of a branch.
- 2.2. CySEC's dedicated Supervisory Action Plan (**the "Plan"**) concerning the FX trading and binary options industry intensified supervisory and enforcement efforts between 2015 and 2018. In the context of implementing the Plan, CySEC identified practices that raised concerns for the investors' protection and resulted in the imposition of fines and licences withdrawals.
- 2.3. CySEC identified that CIFs providing investment services in binary options were engaging in aggressive marketing techniques, and did not always provide adequate information to clients on the risks involved in trading such high risk, speculative instruments. This resulted in retail clients not fully understanding the risks, thereby unable to make an informed investment decision.
- 2.4. CIFs were providing trading benefits to retail clients (in the form of a bonus promotion or otherwise) in the context of their marketing strategies, aiming to attract and encourage retail clients to trade in binary options. Given the complexity of these products, such trading benefits encouraged behaviours proven to not be in the best interests of clients.
- 2.5. Even though binary options do not involve leverage, the potential investors' detriment was exacerbated by the pricing structure, application of transaction fees, and by the short-term nature of these instruments. In addition, retail investors were found to underestimate the risks involved, as a consequence of the oversimplified "yes/no" proposition that formed the basis of such instruments.
- 2.6. CySEC performed an analysis on a sample of binary option client accounts, which confirmed these findings. More specifically, CySEC's analysis was conducted on a sample of 10 binary options providers for the period from 1 January 2017 to 31 August 2017. Our analysis revealed that on average, 87% of client accounts made a loss over that period.

- 2.7. Similar findings were reported by other National Competent Authorities (“**NCAs**”) of the European Economic Area (“**EEA**”) in relation to the provision of investment services in Binary Options.
- 2.8. The characteristics and the risks that binary options entail are further explained in the recitals of the ESMA Decision on Binary Options, respectively and in the [ESMA Product Intervention Analysis](#) in relation to the measures on [binary options](#).

### **CySEC ACTIONS PRIOR TO THE IMPLEMENTATION OF THE ESMA MEASURES**

- 2.9. In view of the above, CySEC issued a series of circulars<sup>4</sup> addressed to CIFs, which provided guidelines to supervised entities to enhance and fundamentally reform their compliance with the regulatory framework. These guidelines included, inter alia; a) a ban on the provision of bonuses encouraging investors to invest in complex financial instruments, b) guidelines for the proper management of conflicts of interest.
- 2.10. Furthermore, a consultation paper<sup>5</sup> was issued proposing the ban of the distribution of binary options to retail investors, except for those meeting specific technical criteria set out by CySEC<sup>6</sup>.
- 2.11. Since 2015, CySEC has also conducted a series of audits and investigations in relation to CIFs providing investment services in binary options under the Plan. The audits revealed serious misconduct by a number of binary option providers, resulting in the imposition of administrative sanctions<sup>7</sup> both to the CIFs and to directors employed by them. CySEC revoked the authorization of CIFs and referred the cases to the Attorney-General of the Republic of Cyprus for possible further action. In addition to these further guidance was provided for the compliance of such firms.

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<sup>4</sup> See: <https://www.cysec.gov.cy/en-GB/public-info/circulars/supervised/investment-firms/>

<sup>5</sup> See: <http://cysec.gov.cy/CMSPages/GetFile.aspx?guid=ebf53e28-2bb7-4494-bb3a-4cced2e3c8ba>

<sup>6</sup> In view of the ESMA Decision on Binary Options, the Consultation Paper was not finalised and by virtue of this Consultation Paper, its content is rendered null and void.

<sup>7</sup> See: <https://www.cysec.gov.cy/en-GB/public-info/decisions/>

## **ESMA MEASURES**

- 2.12. In 2015, an ESMA CFDs Task Force was established, in which CySEC participates, to examine and coordinate the response to the issues CySEC, and other NCAs identified regarding the provision of investment services in binary options and CFDs
- 2.13. ESMA issued a series of questions and answers concerning the provision of investment services in speculative products. Given the risks posed to investor protection, ESMA introduced temporary product intervention measures under MiFIR.
- 2.14. The ESMA measures in relation to binary options included a prohibition on the marketing, distribution or sale of binary options.
- 2.15. It is noted that the ESMA Decision on Binary Options has been renewed three times since its introduction<sup>8</sup>. ESMA has also agreed on the exclusion of a limited number of products from the scope of the measure<sup>9</sup>.

## **CYSEC ACTIONS FOLLOWING THE IMPLEMENTATION OF THE ESMA MEASURES**

- 2.16. CySEC prioritised the effective implementation of the ESMA Decision on Binary Options, aiming to ensure that no binary options are marketed, distributed or sold from or in the Republic of Cyprus.
- 2.17. As part of its supervision, CySEC monitors the investor categorization and onboarding processes to ensure that CIFs do not allow clients to reclassify as elective professional investors, where the criteria provided for in the Law are not met so as to avoid the scope of the measures.

## **CYSEC INTENTIONS**

- 2.18. In view of the fact that ESMA has the power to impose product intervention measures on a temporary basis, CySEC has decided to introduce national measures

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<sup>8</sup> See: <https://www.esma.europa.eu/policy-activities/mifid-ii-and-investor-protection/product-intervention>

<sup>9</sup> See: <https://www.esma.europa.eu/press-news/esma-news/esma-renew-prohibition-binary-options-further-three-months>

pursuant to Article 42 of MiFIR, in order to avoid the resurface of the risks identified, once the effect of the ESMA's measures lapse on 7 July 2019.

- 2.19. The measures that CySEC intends to take aligned with the ESMA temporary product intervention measures, making these measures permanent in relation to the marketing, distribution or sale of Binary Options, in or from the Republic of Cyprus.
- 2.20. Taking into account the risks posed to investors, as have been identified by CySEC in the context of its supervisory responsibilities and by ESMA, and as outlined in the documents referred to in Paragraph 2.8 above, we believe that this is justified, proportionate and meets the criteria of Article 42 of MiFIR, as further elaborated in Article 21 of the European Commission's Delegated Regulation (EU) 2017/567<sup>10</sup>.
- 2.21. In view of the fact that the marketing, distribution and sale of Binary Options is already prohibited as a consequence of the ESMA Decision on binary option, CySEC does not expect that NPIMs will have any additional impact on the market which it supervises. The measures will therefore enter into force with immediate effect without any public consultation.

### **3. MEASURES ON BINARY OPTIONS**

- 3.1. For the reasons referred to in Paragraphs 2.6 – 2.9, CySEC decided at its Board meeting dated 6 May 2019 to adopt the same measures as ESMA in relation to Binary Options.
- 3.2. As a result, the marketing, distribution and sale of Binary Options to retail clients is permanently prohibited from or in the Republic of Cyprus, irrespective of whether these are traded OTC or on a Trading Venue, pursuant to article 42 of MiFIR.
- 3.3. The binary options excluded from the ESMA Decision on Binary Options and the renewals thereof, and therefore from NPIMs, include:
  - 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 commissions, transaction fees and other related costs; and,

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<sup>10</sup> 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

- a binary option that meets cumulatively the following three (3) conditions:
  - a. the term from issuance to maturity is at least ninety (90) calendar days;
  - b. a prospectus drawn up and approved in accordance with the Prospectus Directive (2003/71/EC) or in accordance with the Prospectus Regulation (EU 2017/1129) is available to the public; and
  - c. 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 commissions, transaction fees or other related charges.