

## ANNEX A

### Summary of Comments and CSA Responses on Proposed National Instrument 91-102 *Prohibition of Binary Options*

<u>Section Reference</u>	<u>Summary of Issues/Comments</u>	<u>Response</u>
<b>GENERAL COMMENTS</b>		
General Comments	<p>Commenters generally supported the efforts of the CSA to help protect would-be investors from binary options fraud and generally strengthen the integrity of, and public confidence in, the financial sector, including by ensuring that products cannot be sold to investors through unauthorized mechanisms.</p> <p>One commenter noted that certain investors mistake the current unlawful activity for that of regulated brokers in Canada, and that the reputation of the financial and brokerage industry is, therefore, indirectly at stake.</p>	No change. We thank the commenters for their submissions.
	<p>Commenters had mixed views on binary options:</p> <ul style="list-style-type: none"><li>• One commenter stated that binary options are high risk and not a get rich quick scheme, suggesting that the CSA should not ban binary options for all investors because some people have lost money.</li><li>• Another commenter urged that binary options are, by design, harmful for investors, particularly retail investors. The commenter stated that firms should not be allowed to offer binary options to the public, and particularly not to retail investors.</li></ul>	

	<ul style="list-style-type: none"> <li>• One commenter submitted that the offering of binary options does not enhance any investor portfolio, nor does it enhance fair and efficient capital markets.</li> </ul>	
	<ul style="list-style-type: none"> <li>• Another commenter submitted that non-fraudulent binary options products can be used to offset an existing risk or economic exposure or to speculate on market volatility – for example, to hedge or speculate on very short term market volatility created by the release of specific major economic figures.</li> </ul>	
Will the Proposed NI accomplish the intended purpose?	<p>Commenters generally noted that those operating fraudulent online binary options platforms are unlikely to comply with the Proposed NI.</p> <p>Two commenters stated that the Proposed NI will not end the illegal activity but may interfere with current “legal” institutional binary options trading taking place in the Canadian market.</p> <p>One commenter submitted that the only market participants that will comply with the Proposed NI, such as the large institutional dealers, are already complying with all applicable securities laws and regulations.</p>	<p>No change. The Instrument is one aspect of the CSA’s multi-pronged effort to combat binary options fraud, and we have already seen positive outcomes from this rule-making project.</p>
	<p>Two commenters submitted that the policy objectives could be met with a narrowed scope, and that products traded on a recognized exchange or cleared by a recognized clearing agency or clearing house, or financial instruments legally traded on certain US exchanges should be excluded from the prohibition.</p>	<p>No change. It is currently our view that binary options should not be permitted to be sold to individuals by a registered dealer or regulated exchange.</p>

	<p>One commenter submitted that the detailed regulatory oversight regimes applicable in each Participating Jurisdiction has proven to be effective with respect to other types of instruments, and that any financial product, and not only binary options, that is offered illegally to Canadian investors poses a threat to investors' protection.</p>	<p>No change. It is currently our view that binary options should not be permitted to be sold to individuals by a registered dealer or regulated exchange.</p>
<p>Investor protection</p>	<p>One commenter submitted that, by prohibiting trading of binary options with a maturity of less than 30 days, the regulator is meeting its mandate to provide protection to investors from unfair, improper or fraudulent practices and to foster fair and efficient capital markets.</p>	<p>No change. We thank the commenter for their submission.</p>
	<p>One commenter noted that many of the investor protection-related concerns regarding binary options are also present regarding leveraged retail forex and CFDs, including regarding pricing transparency, and queried whether other leveraged derivatives products sold to retail investors should also be covered in this rule-making project.</p>	<p>No change. The focus of the Instrument is specifically on the fraud being perpetrated by unregulated, online platforms providing primarily – to date – binary options.</p>

Alternative approaches to accomplishing the policy objectives	<p>Commenters pointed to other tools to deter and eliminate fraud relating to binary options, either in support of the Proposed NI or instead of the Proposed NI.</p> <p>One commenter submitted that efforts to attack the bad actors rather than the financial instrument, and that limit demand for the illegal product (e.g., allowing registered firms and exchanges to offer legitimate binary options as a legal alternative) would more effectively protect the Canadian public and reduce the fraud than attempting to ban a financial product.</p>	<p>We note that the Instrument is one aspect of the CSA’s multi-pronged effort to combat binary options fraud, and that we have already seen positive outcomes from this rule-making project.</p>
	<p>Four commenters generally felt that fraudulent binary options platforms and their offerings should be dealt with differently than “legitimate” binary options offered by a registered dealer or a recognized exchange, as in the U.S. and certain other jurisdictions.</p>	<p>No change. It is currently our view that binary options will not be permitted to be sold to individuals by a registered dealer or regulated exchange.</p>
Enforcement	<p>One commenter urged that the only effective means of influencing the fraudulent online platforms is through enforcement actions.</p> <p>Another commenter sought more emphasis in the Proposed NI on utilizing enforcement tools and coordinated enforcement action with other jurisdictions to deter and eliminate fraud associated with binary options.</p>	<p>No change. The Instrument is one aspect of the CSA’s multi-pronged effort to combat binary options fraud, and we have already seen positive outcomes from this rule-making project.</p>

<p>Investor warnings and investor education</p>	<p>Two commenters stated that the only way to prevent online fraud is to tell Canadians about this “trading” scam as well as the related “we help recover your money” scam, and urged regulators to continue investor warnings and investor education programs – pointing to other CSA efforts, including: the website <a href="http://www.binaryoptionsfraud.ca">www.binaryoptionsfraud.ca</a>, holding investor information seminars, and advertising warning of the dangers of buying binary options from online platforms.</p>	<p>No change. The Instrument is one aspect of the CSA’s multi-pronged effort to combat binary options fraud.</p>
<p>Coordinating with distribution and facilitation service providers</p>	<p>One commenter noted that major credit card companies have recently taken steps to limit the availability of funding to unregistered providers of binary options. The commenter submitted that the Participating Jurisdictions should also work with search engine providers to limit online advertising of illegal services to Canadian consumers.</p>	<p>No change. The Instrument is one aspect of the CSA’s multi-pronged effort to combat binary options fraud.</p>
<p>Regulating binary options as fraud</p>	<p>Two commenters recommended the RCMP be involved in stopping online binary options fraud, by handling investigations, shutting down websites and prosecuting platforms in coordination with international law enforcement agencies.</p>	<p>No change. The Instrument is one aspect of the CSA’s multi-pronged effort to combat binary options fraud.</p>
<p>Regulating binary options as gambling</p>	<p>One commenter submitted that fraudulent binary options should be treated as gambling activity, regulated by the applicable gambling authority in each province and subject to the Criminal Code, with enforcement by the RCMP.</p>	<p>No change. We are of the view that binary options are securities and/ or derivatives in each Participating Jurisdiction and therefore that regulating the advertising, offering, selling and otherwise trading of binary options is within the CSA’s regulatory jurisdiction and mandate.</p>

	<p>Permitting binary options to be offered by a registered (or exempt) dealer</p>	<p>Two commenters recommended that, if the CSA proceeds with the Proposed NI, that the rule should provide for a general exception for selling binary options through a registered or exempt dealer.</p> <p>One commenter recommended that the CSA allow registered, IIROC-regulated firms to offer these products to all investors (including both retail and sophisticated investors), in order to: ensure the protection of the public against unfair, abusive and fraudulent practices; apply the concepts of investment suitability; and apply disclosure obligations to allow clients to understand the product and the significant risks involved.</p>	<p>No change. It is currently our view that binary options will not be permitted to be sold to individuals by a registered dealer.</p>
	<p>Permitting binary options to be offered on a recognized (or exempt) exchange or cleared by a recognized clearing agency or clearing house</p>	<p>Two commenters recommended that the CSA permit binary options to be offered to individuals on a recognized exchange.</p> <p>One commenter recommended that the CSA permit a registered dealer to offer binary options traded on a recognized exchange, or cleared by a recognized clearing agency or clearing house, noting the level of CSA oversight over a recognized exchange and a recognized clearing agency.</p>	<p>No change. It is currently our view that binary options will not be permitted to be sold to individuals through a recognized exchange or cleared by a recognized clearing agency.</p>
<p>s. 1 – Definition</p>			
<p>Definition of “binary option”</p>	<p>Several commenters suggested that the definition of “binary option” is too broad, as it may prohibit:</p> <ul style="list-style-type: none"> <li>the offering to an individual of an instrument otherwise duly listed on a recognized exchange or cleared by a recognized clearing agency;</li> </ul>	<p>No change. The Instrument is intended to prohibit the advertising, offering, selling and otherwise trading of a binary option to an individual, regardless of whether it is listed on a recognized exchange or cleared by a recognized clearing agency.</p>	

	<ul style="list-style-type: none"><li>conventional options with a term of less than 30 days that are used by individuals;</li></ul>	No change. A conventional option would not become a prohibited “binary option” simply because its term to maturity is less than 30 days.
	<ul style="list-style-type: none"><li>legitimate binary option transactions executed by institutional and sophisticated investors;</li></ul>	No change. The Instrument is intended to prohibit the advertising, offering, selling and otherwise trading of a binary option to an individual, including an individual that is a sophisticated investor.
	<ul style="list-style-type: none"><li>genuine non-fraudulent binary options that have been offered for many years by regulated firms dealing over-the-counter in Europe and Japan, or in the United States on exchanges.</li></ul>	No change. The Instrument is intended to prohibit the advertising, offering, selling and otherwise trading of all binary options to individuals.
	<ul style="list-style-type: none"><li>binary contracts currently being legitimately sold to sophisticated individuals, including products described in the ISDA 2005 Barrier Option Supplement to the 1998 FX and Currency Option Definitions<sup>1</sup>.</li></ul>	Change made. After follow-up consultations with commenters, we have revised the definition of “binary option” to mitigate against the Instrument capturing some products that were not intended to be caught. We believe that some of the products identified to us would not be caught by the definition, while other products – including some identified in the ISDA 2005 Barrier Option Supplement – would be caught. Information available to us indicates that individuals are not actively trading products under the ISDA 2005 Barrier Option Supplement.
	One commenter submitted that the definition may be too narrow, as it may not capture all types of product that present similar concerns and it may be too easy for a fraudulent online platform to work around.	No change. The revised definition of “binary option” reflects a balancing of efforts intended to focus only on the products we intend to prohibit to be traded with individuals.

<sup>1</sup> Available at: <https://www.newyorkfed.org/medialibrary/microsites/fxc/files/2005/fxc051206a.pdf>.

	One commenter submitted that the words, “a lesser amount or” should be deleted from section 1(b) to help mitigate the risk that other products, including those that do not involve an “all or nothing” approach, would be captured under this definition.	Change made. Paragraph (b) of the definition of “binary option” has been revised.
	One commenter submitted that the scope of the Proposed NI should be limited by the scope of contracts set out under the various <i>Derivatives: Product Determination</i> rules <sup>2</sup> .	No change. A number of the exclusions in the <i>Derivatives: Product Determination</i> rules are not appropriate or are not relevant to the Instrument.
s. 2 – Trading binary options with an individual prohibited		
Exclusion for offering binary options to sophisticated investors	One commenter submitted that only an unsophisticated individual is in need of the protection of the Proposed NI, and that sophisticated individuals have the ability to analyze and discern the risks inherent in binary option transactions. The commenter noted that “accredited investors” are considered sufficiently sophisticated that securities can be sold to them without a disclosure document.	No change. It is currently our view that binary options will not be permitted to be sold to individuals, including individuals that are “accredited investors”.
s. 3 – Trading binary options with a person or company other than an individual prohibited		
Not necessary	Two commenters submitted that proposed section 3 should be removed, because any retail investor that has the means to create a company or a trust in order to circumvent a trading ban should be considered a sophisticated investor, and that such an individual should not need the protection of the Proposed NI.	No change. It is currently our view that binary options will not be permitted to be sold to individuals, including through a company or other entity created, or used, solely to trade a binary option.

<sup>2</sup> Manitoba Securities Commission Rule 91-506 *Derivatives: Product Determination*; Ontario Securities Commission Rule 91-506 *Derivatives: Product Determination*; Québec regulation 91-506 respecting Derivatives determination; and Multilateral Instrument 91-101 *Derivatives: Product Determination*.



<p>Impractical</p>	<p>One commenter stated that proposed section 3 would be impractical and difficult to implement, as the dealer would need to look behind its counterparty to determine whether it was created, or is primarily used, to trade a binary option for an individual. The broad wording of the provision means the determination would need to be made in respect of all or almost all of a dealer’s counterparties.</p>	<p>Change made. Section 3 has been revised to better facilitate implementation by entities that comply with all applicable securities legislation in providing legitimate, non-fraudulent contracts and instruments to counterparties that are not individuals and that are not structured to evade the Instrument.</p>
<p>s. 4 – Binary options having a term to maturity of 30 days or longer</p>		
<p>Term to maturity of 30 days or longer</p>	<p>Commenters generally queried the focus on binary options having a term to maturity shorter than 30 days. One commenter requested an explanation for the 30-day term to maturity in the prohibition.</p>	<p>No change. We have reviewed the products being illegally provided on unregistered online platforms and are satisfied that the minimum 30-day term to maturity period is appropriate to balance our objectives.</p>
	<p>Two commenters submitted that all binary options, regardless of duration, present similar concerns and therefore that the Proposed NI should not be limited to only binary options of 30 days or less.</p>	<p>No change. We feel that the minimum 30-day term to maturity strikes an adequate balance between banning the types of quick-turnover products that invite fraudulent activity and not banning legitimate trading in other types of instruments.</p>
	<p>One commenter requested clarification on the application of the 30-day term to maturity in the prohibition.</p>	<p>Change made. Section 4 has been revised to exclude a binary option having a term to maturity of 30 days or longer.</p>
	<p>One commenter stated that the 30-day minimum expiry time is inappropriate, as markets can move very quickly.</p>	<p>No change. The Instrument is designed to prohibit short-term binary options.</p>

	<p>One commenter suggested that the 30-day limitation may preclude a trader from closing out a position through an offsetting trade with less than 30 days to expiration, thereby limiting the trader's ability to take profits or limit losses.</p>	<p>No change. The prohibition applies only to a “binary option”, as defined in the Instrument; therefore, the minimum 30-day term to maturity exclusion serves only to carve out from the prohibition those contracts that (i) meet the definition of “binary option”, and (ii) have a term to maturity of 30 days or longer. The minimum 30-day term to maturity exclusion in no way affects a trader’s ability to trade in, or close out a position in, a contract that is not a binary option.</p>
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**List of Commenters:**

1. Canadian Advocacy Council for Canadian CFA Institute Societies
2. Canadian Market Infrastructure Committee
3. Canadian Foundation for Advancement of Investor Rights
4. Investment Industry Association of Canada
5. Investor Advisory Panel of the Ontario Securities Commission
6. North American Derivatives Exchange, Inc.
7. TMX Group, on behalf of the Bourse de Montréal Inc. and the Canadian Derivatives Clearing Corporation
8. Tyson G.