

IN THE MATTER OF
THE SECURITIES ACT, 1988, SS 1988, c S-42.2

AND

IN THE MATTER OF
RTG DIRECT TRADING GROUP LTD

AND

RTG DIRECT TRADING LIMITED

DECISION

Hearing held: January 22, 2016

Before: The Honourable Larry Kyle and Gordon Hamilton (collectively the “Panel”)

Appearances: Brett Wawro for the Applicants
D.A. Smith for Staff, Securities Division
No appearances by RTG Direct Trading Group Ltd. or RTG Direct Trading Limited, or anyone on their behalf

Date of Decision: February 19, 2016

BACKGROUND:

1. In the Statement of Allegations by Staff of the Financial and Consumer Affairs Authority of Saskatchewan dated November 2, 2015, Staff alleged that RTG Direct Trading Group Ltd. and/or RTG Direct Trading Limited (hereafter the Respondents) “acted as dealers by engaging in the business of trading in securities or exchange contracts or holding themselves out as engaging in the business of trading in securities or exchange contracts in Saskatchewan”, in violation of section 27(2) of *The Securities Act, 1988*.

PRELIMINARY MATTERS:

2. The only preliminary matter deals with whether the business activities of the Respondents, namely the marketing and sale of binary options, fall within the jurisdiction of *The Securities Act, 1988*. This preliminary issue will be addressed in the Analysis portion of these reasons.

EVIDENCE PRESENTED TO THE PANEL

3. Brett Wawro is an investigator who works in the Securities Division of the Financial and Consumer Affairs Authority. His testimony summarized his investigation into the business activities of the Respondents, and was clear, concise, consistent and reliable. No evidence was presented to the contrary. The Respondents nor anyone authorized to act on their behalf appeared.
4. Accordingly, the Panel makes the following findings of fact, on the basis of the verbal testimony of Mr. Wawro and the comprehensive documentary evidence submitted in support of his testimony:
 - a) That the Respondents provided an online trading platform accessible by Saskatchewan residents, to trade binary options;
 - b) That the Respondents were offering binary option trading which involved "0 risk trading" and was "risk free";
 - c) Through the Respondent's public website, the Respondents represented that 'investors' will "own the asset";
 - d) That at no time were the Respondents registered as a 'dealer' in accordance with *The Securities Act, 1988*;
 - e) That a resident of Saskatchewan (hereafter the "Investor") had used his own personal funds to purchase and/or trade binary options through the Respondents' online trading platform over a period of several months, between the time when he opened a 'trading' account in April of 2015 and his last written request for a return of all of his funds on August 19, 2015;
 - f) That the Respondents and/or the Investor now "owned them" (i.e. the platinum and silver trades) "risk free", as stated in an email to the Investor dated May 19, 2015;

- g) That the Investor transferred approximately \$75,000 CAD to the Respondents and that this amount still remains in the possession of the Respondents;
- h) That the Respondents returned \$10,000 to the Investor in July 2015 in response to the Investor's request in late June for a return of this amount, but shortly thereafter made an unauthorized withdrawal for the same amount from the Investor's credit card;
- i) That the Respondents demanded copies of the Investor's personal identification documents (e.g. passport, driver's licence, utility bill, among others) and later demanded additional funds from the Investor (which was refused) of approximately \$20,000 in order for him to obtain a return of his principal investment funds;
- j) That the Respondents proposed that the Investor must sign a "liquidity agreement" before he could receive a return of any of his principal investment funds;
- k) That on August 27, 2015, the day before the Temporary Cease Trade Order was issued by the Saskatchewan Securities Commission, someone presumably acting on behalf of the Respondents, and posing as a representative of the United States Securities and Exchange Commission (SEC), sought additional funds (\$36,733 USD) from the Investor whom was named as an alleged Defendant in a fabricated SEC administrative proceeding involving the Respondents (where the Administrative Law Judge signed the Orders using President Barack Obama's signature).

5. It is not surprising that the Saskatchewan Securities Commission has received this complaint about binary option trading. A CFTC Investor Alert summarized its experiences with consumer complaints about binary options:

The CFTC and SEC have received numerous complaints of fraud associated with websites that offer an opportunity to buy or trade binary options through Internet-based trading platforms. The complaints fall into at least three categories: refusal to credit customer accounts or reimburse funds to customers; identity theft; and manipulation of software to generate losing trades. [see CFTC Investor Alert – Binary Options, found at http://www.cftc.gov/PressRoom/PressReleases/fraudadv_binaryoptions]

6. Again not surprisingly, one of the three categories of complaints to the CFTC was clearly evident in this matter, with the possibility of all three categories having relevance over time. There was evidence that the Respondents refused to reimburse funds to the Investor. The Respondents also requested an excessive amount of personal identity information, enabling identity theft at

some future date to potentially arise. The evidence further disclosed that once the Investor began to aggressively push for a return of his principal investment, his losses began accumulating at an alarming rate in a manner that was inconsistent with the history of his earlier returns throughout the period when he was making additional deposits to his investment account. While it could be simply 'bad luck', there was a disclaimer that the website's information on share values, currency rates, and other items upon which 'wagers' were made, might not be perfectly synchronized with the actual markets. This opens up the possibility that the third category of complaint may also have some application here without the Investor being aware of it at the time. However, there was no evidence presented to the Panel to support complaints under the latter two categories.

ANALYSIS

7. It is necessary to deal with the preliminary issue at the outset concerning the jurisdiction of this Panel over binary options in this specific fact situation.
8. What is a binary option? Various sources have described the uniqueness of a binary option, when compared with other options:

*Binary options have payoffs that are discontinuous, either paying nothing or a considerable amount, depending on the satisfaction of some condition. For example, a cash-or-nothing call is a type of binary option that pays a fixed cash amount if the stock price terminates above the exercise price or pays nothing if the terminal stock price is below the exercise price. ...These binary options are also known as digital options, a name that reflects the all-or-nothing character of their payoffs. [see Robert W. Kolb, *Futures, Options, and Swaps*, 4th ed. (Malden, MA: Blackwell Publishing, 2003) at 597]*

*Once the option holder acquires a binary option, there is no further decision for the holder to make as to whether or not to exercise the binary option because binary options exercise automatically. Unlike other types of options, a binary option does not give the holder the right to purchase or sell the underlying asset. When the binary option expires, the option holder will receive either a pre-determined amount of cash or nothing at all. Given the all-or-nothing payout structure, binary options are sometimes referred to as "all-or-nothing options" or "fixed-return options. [underline added for emphasis; see *CFTC Investor Alert – Binary Options*, found at http://www.cftc.gov/PressRoom/PressReleases/fraudadv_binaryoptions]*

9. Does a binary option trade fall within the scope and jurisdiction of *The Securities Act, 1988*?

The statutory context under which this matter is to be determined involves several statutory provisions and regimes. Section 2(1) of *The Securities Act, 1988* provides various definitions relevant to these proceedings:

(n) “dealer” means a person or company engaging in or holding himself, herself or itself out as engaging in the business of trading in securities or exchange contracts as principal or agent;

(s.1) “exchange” means any person who or company that constitutes, maintains or provides a market place or facilities for bringing together purchasers and sellers of securities and exchange contracts;

(s.2) “exchange contract” means a futures contract or an option that:

- (i) has its performance guaranteed by a clearing agency; and
- (ii) is traded on an exchange pursuant to standardized terms and conditions set forth in the bylaws, rules or regulations of that exchange at a price agreed on when the futures contract or option is entered into on the exchange;

and includes any instrument or class of instruments that meets the requirements mentioned in subclauses (i) and (ii);

(ss) “security” includes:

- (i) any document, instrument or writing commonly known as a security;
- (ii) any document constituting evidence of title to or interest in the capital, assets, property, profits, earnings or royalties of any person or company;
- (iii) any document constituting evidence of an interest in an association of legatees or heirs;
- (iv) any document constituting evidence of an option, subscription or other interest in or to a security;
- (v) any bond, debenture, note or other evidence of indebtedness, share, stock, unit, unit certificate, participation certificate, certificate of a share or interest,

preorganization certificate or **subscription** other than:

(A) a contract of insurance issued by an insurance company licensed pursuant to *The Saskatchewan Insurance Act*; or

(B) an evidence of deposit issued by a bank to which the *Bank Act (Canada)* applies, by a trust corporation or loan corporation licensed pursuant to *The Trust and Loan Corporations Act, 1997*, by a credit union or by Credit Union Central of Saskatchewan;

- (vi) any agreement pursuant to which the interest of the purchaser is valued for purposes of conversion or surrender by reference to the value of a proportionate interest in a specified portfolio of assets;
- (vii) any agreement providing that money received will be repaid or treated as a subscription to shares, stock, units or interests at the option of the recipient or of any person or company;
- (viii) any certificate of share or interest in a trust, estate or association;
- (ix) any profit-sharing agreement or certificate;
- (x) any certificate of interest in an oil, a natural gas or a mining lease, a claim or a royalty voting trust certificate;
- (xi) any oil or natural gas royalties or leases or any fractional or other interest in them;
- (xii) any collateral trust certificate;
- (xiii) any income or annuity contract not issued by an insurance company licensed pursuant to *The Saskatchewan Insurance Act*;
- (xiv) any investment contract; and
- (xv) any document constituting evidence of an interest in a scholarship or educational plan or trust;
- (xvi) any item or thing not mentioned in subclauses (i) to (xv) that is a futures contract or option but is not an exchange contract;

whether any of the foregoing relate to an issuer or proposed issuer;

(vv) "trade" includes:

(i) any transfer, sale or disposition of a security for valuable consideration, whether the terms of payment be on margin, instalment or otherwise, but does not include a purchase of a security or, except as provided in subclause (iv), a transfer, pledge, mortgage or encumbrance of securities for the purpose of giving collateral for a bona fide debt;

(i.1) any entering into of an exchange contract;

(ii) any participation as a floor trader in any transaction in a security or an exchange contract on the floor of any exchange;

(iii) any receipt by a registrant of an order to buy or sell a security or an exchange contract;

(iv) any transfer, pledge, mortgage or encumbering of a security from the holdings of a control person for the purpose of giving collateral for a bona fide debt; and

(v) any act, advertisement, solicitation, conduct or negotiation directly or indirectly in furtherance of anything mentioned in subclauses (i) to (iv);

10. The evidence was clear that the Respondents were holding themselves out as providing a trading platform for binary option investors. The crucial question is whether binary options constitute a security, in situations where an investor normally has no expectation of ever owning anything. In this matter, the Respondents actually provided confusing and contradictory information to investors generally, including the Investor, about whether there were any ownership rights at all. As noted previously, the Respondents represented generally on their website (i.e. "own the asset") and specifically to the Investor at one point (i.e. "own them risk free"), that there was an ownership status associated with the binary option trades.

11. If the confusion about ownership is resolved such that no ownership interest is created by the Respondents nor expected by investors, what impact does that have on the status of binary options in relation to the definition of a 'security' under *The Securities Act, 1988*?

12. The practical experience, generally and in this instance, is that the binary contract arrangement involves a contract between an offshore entity who is running an investment platform which is marketed to speculative investors. The typical scenario was evident in this instance, whereby the Respondents were offering a significant (or even unbelievable) return on the investment if the investor 'guessed correctly' on the trajectory of a stock's value over a specified period of time. In some cases, the time period could be as brief as one minute in duration. In other cases, the time period was much longer. The common outcome was that if the investor 'guessed wrong', the money attached to that binary option contract (or his wager) would be completely lost to the investor. All binary contracts are cash settled, with the usual understanding that no ownership in the actual stock was created. In this instance, the confusion created by the Respondents on the issue of ownership will be examined below for its implications to the issue of jurisdiction.

13. The Ontario Securities Commission has published *OSC Staff Notice 91-702 Offerings of Contracts for Difference and Foreign Exchange Contracts to Investors in Ontario (91-702)*, which examines contracts for difference (CFD) activities. It described CFDs as follows:

A CFD typically involves a contract between two parties, a seller and a buyer, that creates payment rights and obligations based on the price movements of the underlying asset. CFDs allow investors to take long or short positions in relation to the underlying asset but, unlike futures contracts, have no fixed expiry date or contract size.

14. The parallels between CFD arrangements and binary options are striking. These would include the fact that "the original seller of the CFD is also the only possible buyer for an investor", which is identical to the binary option contracts scenarios. The OSC's Staff Notice 91-701 further states:

A CFD is a derivative product that allows an investor to obtain economic exposure (for speculative, investment or hedging purposes) to an underlying asset (the underlying asset), such as a share, index, market sector, currency or commodity, without acquiring ownership of the underlying asset. CFDs are generally cash-settled...

15. Binary options are always cash settled, without acquiring ownership in the underlying asset (notwithstanding the confusion in the representations by the Respondent in this matter). It is in essence a derivative product, allowing an investor to realize a return on the investment on the basis of the price movements of the underlying asset. Like most derivatives, the value or return

of a binary option is based upon the variations in the performance of an underlying asset, whether or not there are any ownership rights that may be exercised in the underlying asset.

16. The Panel has considered the approaches adopted by other regulators as providing some general guidance and assistance. In the United States, the Cantor Exchange, the Chicago Mercantile Exchange, Inc. and the North American Derivatives Exchange, Inc. offer binary options. These are all regulated exchanges subject to the U.S. Commodities Futures Trading Commission.
17. In an American decision, *Caiola v. Citibank, N.A.*, N.Y., 295 F.3d 312, 326-27 (2d Cir. 2002), the Court ruled that whether or not options are cash settled, rather than settled by delivery of the underlying assets, has no impact on whether the options qualify as "securities" under the applicable statute.
18. The New Brunswick Financial and Consumer Services Commission (NBFCSC - an equivalent agency to Saskatchewan's Financial and Consumer Affairs Authority which includes the Saskatchewan Securities Commission) recently determined that binary options constituted derivatives under its statute so as to fall within the scope of its regulations. Whereas the NBFCSC was able to rely upon a definition of 'derivative' that explicitly included options in its legislation, Saskatchewan does not have such a convenient and explicit definition available to it upon which it can rely.
19. The potential or alleged 'ownership' interest in the underlying security allows for an easier conclusion that binary options in this instance fall within the jurisdiction of *The Securities Act, 1988*. In 1978, the Supreme Court of Canada considered what constitutes a security in its decision, *In the Matter of the Securities Act, R.S.O. 1970, Chapter 426 and Amendments thereto; And in the Matter of Pacific Coast Coin Exchange of Canada Limited*, [1978] 2 S.C.R. 112 (S.C.C.). In *Pacific Coast*, the Supreme Court identified the necessary components of an investment contract at paragraph 129. An investment contract must include:
 - (i) the advancement of money by an investor,
 - (ii) with an intention or expectation of profit,

- (iii) in a common enterprise in which the fortunes of the investor are interwoven with and dependent upon the efforts and success of those who solicit the capital or third parties, and
- (iv) where the efforts made by those other than the investors are the undeniably significant ones, those essential managerial efforts which affect the failure or success of the enterprise.

20. In this instance, the Respondents solicited the advancement of money from an investor who intended and expected to make a profit (otherwise, no one would advance any funds). The evidence confirmed that the fortunes of the investor were highly dependent upon the efforts of the Respondents. In one email, the Respondents wrote:

We had a good day trading but what we really did was basically this, we protected our positions and that's the key to trading in our open positions we are down in platinum and silver, but why was today so important, I day traded silver and platinum, and now I own them basically risk free, you will get a report later today or tomorrow...

21. Of course, we have no way to know if the stated activities of the Respondents actually occurred, but on its face it appears that the Investor was entirely dependent upon the Respondents and their efforts, and that those efforts affected the investor's success on that particular day of trading.

22. On this basis, the test for what constitutes an investment contract established in *Pacific Coast* was fully satisfied by the facts underlying the Respondents' business operations. When the specific definitions of *The Securities Act, 1988* are examined, the references in both the Investor email and the website provide the important element of an ownership interest in one portion of the definition of a 'security', even if it was as tenuous and optional as the ownership interest facts arising in the *Pacific Coast* decision. In the *Pacific Coast* decision, investors would normally accept a cash settlement rather than take ownership in a bag of silver coins. However, the physical possession and ownership of the bag of silver coins was available to the investor if desired (although perhaps not a very practical ownership right to exercise in normal investment practices).

23. In reliance upon the representations of ownership on both a general and a specific level in relation to the Investor, the factual similarities with the facts in *Pacific Coast* confirm that binary options satisfy the criteria enumerated by the Supreme Court of Canada in that case. On that factual premise, the binary options in this instance would be securities pursuant to section 2(1)(iv), on the basis that there would be an option or other interest in a security.
24. In the event that the representations regarding 'ownership' were misunderstood, this Panel has concluded that binary options are securities pursuant to section 2(1)(xiv) in that they are investment contracts. Even without any ownership rights in the underlying security, the criteria as established in *Pacific Coast* for an investment contract was satisfied. However, without any ownership rights to exercise, a binary option does not fall within section 2(1)(iv). A binary option is unlike most options since there is no right or pretence to convert the option into ownership. Notwithstanding the distinction and factual contradictions regarding ownership in relation to the binary options contracts sold by the Respondents, these binary options still fall under the jurisdiction of *The Securities Act, 1988* and this Panel for the reasons stated above.
25. The allegation includes the assertion that the Respondents not only engaged in the business of trading in securities, but also held themselves out as being in the business of trading securities. The direct emails to the Investor and the website references more than satisfy the 'holding out' requirement to support this complementary allegation.
26. Having found that a binary option is a security within the meaning of *The Securities Act, 1988*, it is unnecessary to determine whether a binary option is an exchange contract. There was no argument presented to the Panel suggesting that a binary option was an exchange contract (and it has been noted that the written submission expressly suggested that a binary option was not an exchange contract). Accordingly, the Panel makes no determination as to whether a binary option is an exchange contract pursuant to section 2(1)(s.2).

SANCTIONS REQUESTED

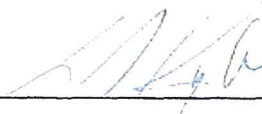
27. The requested sanctions are that the Panel issue the following orders, provided it is confirmed to be in the public interest:

- a) Pursuant to subsection 134(1)(a) of the Act, all of the exemptions in Saskatchewan securities law do not apply to the Respondents;
- b) Pursuant to subsection 134(1)(d) of the Act, the Respondents shall cease trading in any securities or exchange contracts in Saskatchewan;
- c) Pursuant to subsection 134(1)(d.1) of the Act, the Respondents shall cease acquiring securities or exchange contracts for and on behalf of residents of Saskatchewan;
- d) Pursuant to section 135.1 of the Act, the Respondents shall pay an administrative penalty to the Financial and Consumer Affairs Authority of Saskatchewan in the amount of \$25,000;
- e) Pursuant to section 135.6 of the Act, the Respondents shall pay compensation to each person or company found to have sustained financial loss as a result, in whole or in part, of the Respondents' contraventions of the Act, in an amount to be determined; and
- f) Pursuant to section 16.1 of the Act, the Respondents shall pay the costs of or relating to the hearing in this matter.

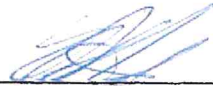
DECISION OF THE PANEL:

28. Contradictory evidence about a right to exercise an ownership interest in the securities underlying the investment contract prevented the Panel from concluding whether the Respondents' binary options that were sold to the Investor were securities in accordance with subsection 2(1)(ss)(iv) and (xvi). However, the Panel has confidently determined that binary options are securities within the scope of subsection 2(1)(ss)(xiv), being investment contracts, regardless of the factual circumstances surrounding ownership interests. Having found that the Respondents' binary options were securities under *The Securities Act, 1988*, it is unnecessary to make any definitive or restrictive conclusions concerning whether another binary option could be a security pursuant to subsections 2(1)(ss)(iv) and (xvi).
29. Given that the Respondents are not registered as dealers in Saskatchewan, the allegation has been proven that the Respondents "acted as dealers by engaging in the business of trading in securities or holding themselves out as engaging in the business of trading in securities in Saskatchewan" contrary to section 27(2) of *The Securities Act, 1988*.

30. The Sanctions requested of the Panel are approved and the consequential orders will be issued to accompany this decision. The monetary sanctions are within the range of sanctions granted in comparable circumstances based upon the cases cited by counsel and reviewed by the Panel. The Panel was amenable to greater monetary sanctions given the atrocious and fraudulent actions of the Respondents, particularly the Respondents' subsequent attempt (and the attempt by someone likely acting on their behalf posing as the United States SEC) to extract additional funds from the Investor after he had requested the return of his investment funds.
31. The Panel will issue its final and binding order after it has received submissions on the costs being sought in this matter.



The Honourable L. Kyle, Hearing Panel Member



Gordon D. Hamilton, Hearing Panel Chair