

Public Statement

On the application of the national product intervention measures on binary options to event contracts

Background

ESMA and NCAs observe the increased offering of “event contracts” and growth of so-called “prediction markets”. Event contracts are agreements whose financial outcome is binary (a fixed payout or no payout at all) and depends on a yes-or-no answer to a question about a future event.

Event contracts exist for a wide variety of event questions. Not all event contracts are financial instruments. Only event contracts with an event question related to an underlying mentioned in Section C(4) to (10) of Annex I of MiFID II classify as financial instruments.¹

Event contracts qualifying as financial instruments are derivatives and fall within the scope of the temporary product intervention measures on binary options which were initially adopted by ESMA Decision (EU) 2018/795² and which were subsequently replaced by permanent national product intervention measures mirroring the ESMA temporary measures. This means that the marketing, distribution or sale to retail clients of event contracts that meet the definition of financial instruments is prohibited.

This statement, which is addressed to firms and NCAs, is a reminder that firms should assess whether the national product intervention measures apply to the products they offer, based on the specific product characteristics. While this public statement specifically mentions financial instruments marketed as event contracts, the assessment of whether the national product intervention measures apply should be conducted for all financial instruments with similar characteristics to event contracts.

Scope of the national product intervention measures on binary options

¹ Event contracts may also classify as a bet under national gambling legislation and/or, for the event contracts taking the token form and that are not financial instruments, as crypto-assets regulated under MiCA .

² 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) (**ESMA Decision**). The application of the ESMA measures was confirmed by subsequent quarterly decisions, until 1 July 2019. In the meantime, all NCAs adopted permanent national PI measures mostly mirroring the mentioned ESMA decision, without any changes. These national PI measures are currently in place in all Member States of the EU.

National product intervention measures on binary options have been adopted by NCAs in the respective jurisdictions. These national measures reflect the original temporary measures adopted by ESMA in 2018. The ESMA Decision included a definition of binary options for the specific purpose of the financial instruments affected by that decision.³⁴

In this context, the commercial name provided by firms (e.g. “event contracts”) is irrelevant for the categorisation under MiFID II of products distributed, marketed or offered to clients, and firms must conduct a careful legal analysis of these products and their functioning, in order to check whether they may fall within the scope of application of product intervention measures. Firms must conduct this careful legal analysis by adhering at all times to the overarching obligation to act honestly, fairly and professionally in accordance with the best interests of clients, to which they are bound.⁵

Consequently, as event contracts with a binary outcome and binary pay-out are likely to be derivatives that are financial instruments, they are likely to fall in scope of the product intervention measures. In some cases, an investor may receive a ‘coupon’ or ‘reward’ representing the interest earned on the funds paid. The existence of such ‘coupon’ or ‘reward’ does not change the binary nature of the event contract itself.

MiFID authorisation required for distribution to non-retail clients

Being financial instruments, ESMA also reminds firms that the provision of investment services and activities concerning financial instruments in the EU requires an authorisation in accordance with MiFID II, irrespective of the category of clients to whom services are provided. As a consequence, the distribution of such event contracts even only to non-retail clients requires this authorisation.

³ “For the purposes of paragraph 1, irrespective of whether it is traded on a trading venue, a binary option is 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;
- (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.”

⁴ Certain binary options (as described in paragraph 3 of Article 2 of the ESMA Decision) were however excluded from the scope of the product intervention measures.

⁵ ESMA notes that participating in circumvention activities to the product intervention measures is prohibited.