

PUBLIC NOTICE
on the issuance of a
MEASURE OF A GENERAL NATURE
regarding Product Intervention in Relation to Binary Options
of 18. 6. 2019

The Czech National Bank (hereinafter the “CNB“), as the competent authority in the Czech Republic in accordance with Article 192a(1)(h) of Act No. 256/2004 Coll., on Capital Market Undertakings, as amended (hereinafter the “ACMU”), in connection with Article 42 of Regulation (EU) No 600/2014 on markets in financial instruments (hereinafter “MiFIR”), issues, based on Article 136(1)(r) of the ACMU, in connection with Article 42(1) of MiFIR, this measure of a general nature in accordance with Article 171 et seq. of Act No. 500/2004 Coll., the Administrative Code, as amended:

I. Investment firms in accordance with Article 2(1)(1) of MiFIR and credit institutions in accordance with Article 2(1)(19) of MiFIR (hereinafter referred to jointly as “Investment Firms”) are prohibited from marketing, distributing or selling binary options in the Czech Republic and from the Czech Republic to other than professional clients in accordance with Article 2a and Article 2b of the ACMU.

II. Binary options in accordance with Article I are understood to be a derivative that meets the following conditions:

- a) It is a financial instrument in accordance with Article 2(1)(29) of MiFIR in connection with Article 4(1)(44)(c) of Directive 2014/65/EU on markets in financial instruments;**
- b) 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;**
- c) It enables payment only when positions are closed or upon maturity; and**
- d) Its payment is limited to a pre-set amount or zero, if the derivative’s underlying asset meets or does not meet one or more pre-set conditions.**

III. The prohibition in accordance with Section I does not apply to:

- a) Binary options where the lower of the two pre-set fixed amounts of payment is equal to at least the amount paid by the client for the acquisition of the binary option, including commissions, transaction fees and other related costs;**
- b) Binary options that meet the following conditions:**

- i. The period from the date of issue to the date of maturity is at least 90 calendar days;**
- ii. A prospectus was issued in accordance with the ACMU or a comparable foreign legal regulation governing the publication of a prospectus for a public offer of securities or in accordance with a directly-applicable European Union regulation governing a prospectus that is to be published for a public offer or the acceptance of securities for trading on a regulated market;**
- iii. The binary option does not expose the Investment Firm that markets, distributes or sells it to market risk and neither the Investment Firm nor a person to which it is linked by control, common influence or association in accordance with Article 22(3) of Act No. 563/1991 Coll., on accounts, as amended, obtained from the binary option a yield over the framework of the pre-notified commission, transaction fees and other related fees.**

Justification

1. LEGAL FRAMEWORK

1. In accordance with Article 42 of MiFIR, the competent authority of a Member State can, in the Member State or from the Member State, prohibit or restrict the marketing, distribution or selling of certain financial instruments,¹ financial instruments with certain set characteristics or a certain type of financial activities or practices, if it reasonably believes that a financial instrument, structured deposit or activity or practice gives rise to significant investor protection concerns. When doing this, it will take into consideration the criteria and conditions for the prohibition or restriction stated therein. A more detailed definition of some criteria is contained in Article 21(2) of Regulation (EU) 2017/567, 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. Such measure can have a preventative nature (conclusion of Article 42(1) of MiFIR: “Where the conditions set out in the first subparagraph are fulfilled, the competent authority may impose the prohibition or restriction referred to in paragraph 1 on a precautionary basis before a financial instrument or structured deposit has been marketed, distributed or sold to clients.”).
2. In accordance with Article 1(2) of MiFIR, the regulation “applies to investment firms authorised under Directive 2014/65/EU and credit institutions authorised under Directive 2013/36/EU of the European Parliament and of the Council when providing investment services and/or performing investment activities and to market operators including any trading venues they operate,” (with the deviations specified below, which, however, do not concern the scope of Article 42 of MiFIR).²

¹ In MiFIR a financial instrument is understood to mean the instruments defined in Czech law as investment instruments in accordance with Article 3 of the ACMU.

² The term “Investment Firm” corresponds, in Czech law, to the terms (1) securities dealer, (2) foreign person that has a license from the supervisory body of another European Union Member State for the provision of investment services, and (3) foreign person in accordance with Article 28(1) of the ACMU (i.e. a person from a country that is not a European Union Member State) that provides investment services in the Czech Republic through a branch. The term “Credit Institution” corresponds, in Czech law, to a bank and a foreign bank (and also a savings and loan co-operative that, however, is not entitled to provide services related to binary options).

3. The competent authority in the Czech Republic in accordance with Article 42 of MiFIR is the CNB, based on Article 192a(1)(h) of the ACMU.
4. For the purpose of complying with Article 42 of MiFIR, the CNB is entitled, in accordance with Article 136(1)(r) of the ACMU “to suspend the marketing or sale of investment instruments or structured deposits if the conditions stipulated in Articles 40 to 42 of Regulation (EU) No 600/2014 of the European Parliament and of the Council are met”.
5. This measure concerns an uncertain group of persons, but in accordance with MiFIR it is a supervisory measure, not a legal regulation, and it is therefore a measure of a general nature in accordance with Article 171 of the Administrative Code. The necessity of a material assessment of the characteristics of a measure of a general nature is confirmed, inter alia, by case law of the Constitutional Court (file ref. Pl. ÚS 19/11). This measure differs from a legal regulation, inter alia, through the CNB’s duty in accordance with Article 42(6) of MiFIR, “The competent authority shall revoke a prohibition or restriction if the conditions in paragraph 2 no longer apply”.
6. The duty in accordance with Article 42(6) of MiFIR also means that a “prohibition” in accordance with Article 42(1) of MiFIR is identical to “suspending” in accordance with Article 136(1)(r) of the ACMU, as in both cases it is a prohibition valid “until rescinded”, or rather until a change to the conditions, but not necessarily a permanent prohibition.
7. In accordance with Article 199(6) of the ACMU, the CNB publishes a draft measure of a general nature in accordance with the ACMU and a measure of a general nature in accordance with the ACMU only in a manner enabling remote access.

2. CURRENT MEASURES AT THE EUROPEAN UNION LEVEL AND THEIR TERMINATION

8. Under European Securities and Markets Authority (ESMA) Decision (EU) 2018/795 there was a temporary prohibition against the marketing, distribution and sale of binary options to other than professional clients (hereinafter a “Non-professional Client”), valid from 2 July 2018 for a period of three months.
9. In accordance with Article 40(6) of MiFIR, ESMA has to review product interventions at reasonable intervals, at least every three months.
10. During a review, new information came to light concerning:
 - a) Binary options where the client always gets at least the amount put in back; and
 - b) Binary options that are sufficiently long-term that a prospectus is issued for them and the provider of the binary option or another person from the same group is fully hedged against the risk resulting from them.³

In the case of such binary options, it is not probable that they would give rise to the significant client protection concerns stated in ESMA Decision (EU) 2018/795.

11. With regard to these reasons and the lasting nature of the reasons stated in ESMA Decision (EU) 2018/795, ESMA Decision (EU) 2018/1466 of 21 September 2018 renewed the prohibition for another three-month period, but removed binary options meeting the conditions in accordance with the previous paragraph from its remit.
12. ESMA Decision (EU) 2018/2064 of 14 December 2018 and ESMA Decision (EU) 2019/509 of 22 March 2019 renewed the prohibition to an unchanged extent for the next three-month period.

³ An inline warrant is an example of this type of binary option.

13. ESMA stated that the main reasons for product intervention regarding binary options were, in particular, a significant risk to the protection of Non-professional Clients, the complicated nature of the product or its specific properties (in particular, its highly speculative nature, similarity to gambling), the extent of potential unfavourable consequences and the degree of the disproportion between the yield and the risk of loss for clients.
14. An ESMA decision in accordance with Article 40 of MiFIR has a temporary nature. It can be renewed, but renewal should not mean the introduction of a permanent prohibition, as such procedure would be in conflict with its temporary nature.
15. Some national competent authorities have notified, using the procedure in accordance with Article 42(3) of MiFIR, of preparations for the adoption of product intervention measures at the domestic level.⁴ According to information the Czech National Bank has, others have declared their plan to do so in the course of 2019.
16. Based on ESMA's opinions, it is clear⁵ that ESMA's product interventions will not be renewed and the fears concerning a significant threat to the protection of Investment Firms' clients in the Czech Republic, as well as the foreign clients of Investment Firms from the Czech Republic, need to be dealt with by a CNB measure in accordance with the rules in Article 42 of MiFIR.
17. The conditions for an ESMA temporary measure and for measures of the competent authorities in Member States are basically the same in MiFIR and the regulation does not require the documentation of conditions based on data from each EU Member State, but it does require protection of clients in Member States from a risk that results from the nature of an instrument or activities, even in only one EU Member State. The aim of the authorisation in MiFIR is preventative protection of investors in cases where, due to the nature of a certain instrument (activities or practices), there is a risk of material detriment (conclusion of Article 42(1) of MiFIR).

3. COMPLIANCE WITH SUBSTANTIVE LAW CONDITIONS FOR ISSUE OF THIS MEASURE

3.1. "Financial Instrument"

18. A measure in accordance with Article 42 of MiFIR can concern financial instruments, activities and practices, or structured deposits.
19. A binary option is an instrument that is a derivative and is settled in cash, where the payment of a fixed monetary amount depends on whether one or more specified events occurs or does not occur in connection with the price, level or value of the underlying asset on the day the derivative expires or before it.⁶ A binary option enables a client to "bet" on whether certain events will occur in connection with the price, level or value of one or more underlying assets (e.g. shares, currencies, commodities or an index). If such event does not occur, the client loses his money [the option ends out-of-the-money (OTM)]. If the event occurs, the option is paid out or the contract remains valid with the

⁴ The Polish authority Komisja Nadzoru Finansowego (KNF), the Austrian authority Finanzmarktaufsicht (FMA), the Dutch Authority for Financial Markets (AFM), the British Financial Conduct Authority (FCA).

⁵ Based on information from meetings of the ESMA supervisory authority board.

⁶ The lower of two monetary payments is usually zero, but this does not have to be the case. Binary options are different to other speculative products sold to Non-professional Clients because they are contracts for difference in that a pre-set monetary amount is to be paid out and it is not directly related to the size of the change in the price, level or value of the underlying asset.

option of receiving a payment, if another contracted event occurs [the option ends in-the-money (ITM)].

20. In accordance with Article 2(1)(9) of MiFIR, a financial instrument is understood to be a financial instrument as defined in Article 4(1)(15) of Directive 2014/65/EU of the European Parliament and of the Council on markets in financial instruments (hereinafter “MIFID II”), which further refers to Annex I to the directive, which defines financial instruments in Section C, inter alia:
- a) In section 4 as “Options ... and any other derivative contracts relating to securities, currencies, interest rates or yields, or other derivatives instruments, financial indices or financial measures which may be settled physically or in cash”;
 - b) In section 5 as “Options ... and any other derivative contracts relating to commodities that 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”;
 - c) In section 10 as “Options ... and any other derivative contracts relating to climatic variables, freight rates or inflation rates or other official economic statistics that 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, as well as any other derivative contracts relating to assets, rights, obligations, indices and measures not otherwise mentioned in this Section, which have the characteristics of other derivative financial instruments, having regard to whether, inter alia, they are traded on a regulated market, OTF, or an MTF”.

The characteristics of other derivative financial instruments are specified in further detail in Article 10 of Regulation No (EU) 2017/565.

21. Depending on the underlying asset, the instrument described in paragraph 19 has the characteristics of a financial instrument, always in the case of ordinary underlying assets (financial indicators in Section 4, commodities in section 5, the climate, freight costs and official statistics in Section 10),⁷ otherwise if other characteristics are present.

3.2. “Significant Investor Protection Concerns”

22. In accordance with Article 42(2)(a)(i) of MiFIR it is possible to adopt a prohibition or restriction if the instrument (or the activity or practice) under assessment gives rise to significant investor protection concerns or poses a threat to the orderly functioning and integrity of financial markets or commodity markets or to the stability of whole or part of the financial system, even preventatively (conclusion of Article 42(1) of MiFIR).
23. Binary options, with regard to the relatively small volumes of trading, are not a threat to the financial system or part thereof, they do not give rise to concerns about the orderly functioning of commodity markets. They can, however, give rise to significant investor protection concerns, specifically for Non-professional Clients, and therefore be a threat to the orderly functioning of financial markets. Further, the CNB dealt with the condition of significant investor protection concerns.
24. The significant investor protection concerns regarding binary options were assessed by the CNB as concerns about investor protection in the Czech Republic. Nevertheless, the CNB, in accordance with the purpose of the provisions in MiFIR, had to take into consideration investor protection in other Member States; in the event there was a risk binary options

⁷ This concerns the points of Annex I, Part C of MIFID II.

could be offered by securities traders from the Czech Republic. Regarding the scope of this measure of a general nature see also part 3.6.

25. When determining whether there are such concerns, the CNB assessed the criteria and factors stated in Article 21(2) of Regulation (EU) 2017/567. In accordance with Article 21(1) of this regulation, the competent authorities can determine the existence of significant investor protection concerns based on one or more of the factors or criteria stated. When taking them into consideration, the CNB reached the conclusion that ordinary binary options give rise to investor protection concerns, for the reasons specified below.

3.2.1. Degree of Complexity of Financial Instrument⁸

26. Binary options are a complicated (complex) financial or investment instrument, as they do not have the characteristics of a simple investment instrument in accordance with Article 15k of the ACMU (instruments containing a derivative are excluded from the definition of simple instruments). Their nature is, with regard to the conditions of trading, significantly more complicated than the nature of other financial instruments that are not regarded as simple, for example shares that are not traded publicly.
27. Binary options have a number of characteristics because of which they are hard to understand for Non-professional Clients. In particular, they require that clients precisely assess the value of an option in relation to the expected probability of occurrence of the reference event, which is further complicated by the fee structure.
28. Non-professional Clients usually invest in binary options outside organized markets. This means that pricing strategies, performance and settlement of binary options are not standardized.
29. Binary options are usually a very short-term investment, in some cases they expire a few minutes after purchase, and so they are very speculative.
30. Non-professional Clients may not realize that if a transaction is very short-term or a position is closed close to expiry, then factors usually used for pricing strategies for options, such a historical volatility, only have little influence on the option's value.⁹
31. With regard to the stated factors, it is very complicated for Non-professional Clients to objectively determine the value of binary options,¹⁰ or to estimate their real value.

3.2.2. Degree of Transparency with Regard to Underlying Assets¹¹

32. Providers of binary options – i.e. Investment Firms providing services in relation to binary options, either as a party to a contract on binary options (or the issuer in the case of securitized binary options) or as intermediaries – often require that clients agree that the prices used for determining the value of a binary option can differ from the price available on the relevant market in the underlying assets. This means that clients may not always be able to verify whether the prices that the provider tells them are appropriate.¹² Even the possible availability of a (credible) market price of the underlying asset does not deal with the concerns, as short-term price trends are essentially random (see below).

⁸ Article 21(2)(a) of Regulation (EU) 2017/567.

⁹ Recital 19 of the preamble to Decision (EU) 2018/795.

¹⁰ Recital 24 of the preamble to Decision (EU) 2018/795.

¹¹ Article 21(2)(a), point one, of Regulation (EU) 2017/567.

¹² Recital 24 of the preamble to Decision (EU) 2018/795.

3.2.3. Degree of Transparency of Costs and Fees¹³

33. Binary options are linked to a complicated structure of prices, poor availability of information about pricing strategies and the existence of even more complicated offers (such as instruments that represent a set of several binary options, or asymmetrical or inconsistent surcharges¹⁴). This increases the complexity of such products and, even more, restricts the ability of Non-professional Clients to understand the risks of a certain binary option.¹⁵ Some aspects of the fees (“two way pricing”) are described in detail in the ESMA analysis.¹⁶

3.2.4. Complexity of Performance Calculation¹⁷

34. The necessary expert knowledge for trading in binary options includes knowledge of probability theory and the ability to apply it to specific transactions in binary options.¹⁸ Although Non-professional Clients can use ordinary tools to determine the price of binary options for searches and pricing strategies, such as the Black-Scholes formula, in comparison with the providers of binary options they have disproportionately more limited knowledge and information.¹⁹

35. Providers of binary options also have a lot more experience with pricing strategies for such type of instrument than Non-professional Clients do and there is a greater probability that they have created sophisticated pricing strategy methodologies.²⁰

3.2.5. Nature of Risks²¹

Causes: Conflict of Interests, Complexity and Low Transparency of Binary Options

36. The structure of prices in combination with the use of transaction fees for every transaction leads to the vast majority of Non-professional Clients losing the funds they invest²² (despite any short-term profits) and the providers of binary options that are usually the direct counterparty in the relevant transaction generate long-term profits that correspond to the clients’ losses on trading and transaction fees.

37. The interests of providers of binary options are in direct conflict with the interests of clients, which increases the risk that a provider can manipulate the price of the underlying asset when a binary option expires or extend the validity of a binary option (possibly even by seconds or milliseconds), so that an option is not in-the-money. The risk of a conflict of interest is exceptionally high for binary options, as the remuneration for such products is determined by whether the underlying asset reached a certain price or value at a precise time, as well as the fees, including the margin.²³

¹³ Article 21(2)(a), point two, of Regulation (EU) 2017/567.

¹⁴ Recital 30 of the preamble to Decision (EU) 2018/795.

¹⁵ Recital 23 of the preamble to Decision (EU) 2018/795.

¹⁶ ESMA: Product Intervention Analysis: Measure on Binary Options, 2018 (accessible at www.esma.europa.eu), pp. 23 – 24, with the addition that the negative expected yield of binary options applies regardless of the amount of fees, pp. 13 (footnote 4).

¹⁷ Article 21(2)(a), point three, of Regulation (EU) 2017/567.

¹⁸ CNB Statement *Provision of Services for Binary Options* of October 2015 at www.cnb.cz.

¹⁹ Recital 17 of the preamble to Decision (EU) 2018/795 including the footnote stated therein.

²⁰ Recital 19 of the preamble to Decision (EU) 2018/795.

²¹ Article 21(2)(a), point four, of Regulation (EU) 2017/567.

²² ESMA: Product Intervention Analysis: Measure on Binary Options, 2018, pp. 25.

²³ Recital 30 of the preamble to Decision (EU) 2018/795.

38. The ability of Non-professional Clients to properly assess options is limited, even when using the tools available to them.²⁴ In addition, with regard to the application of the provider's margin and other transaction fees, Non-professional Clients would regularly have to exceed the expected return on investment for trading to be profitable for them.
39. The CNB therefore – the same as ESMA and other competent authorities in the European Union – justifiably believes that for Non-professional Clients it is extraordinarily difficult to make an informed decision on the risk and reward of a specific product and therefore to make an informed decision on such investment.²⁵

High Risk of Losses and Expected Negative Yield

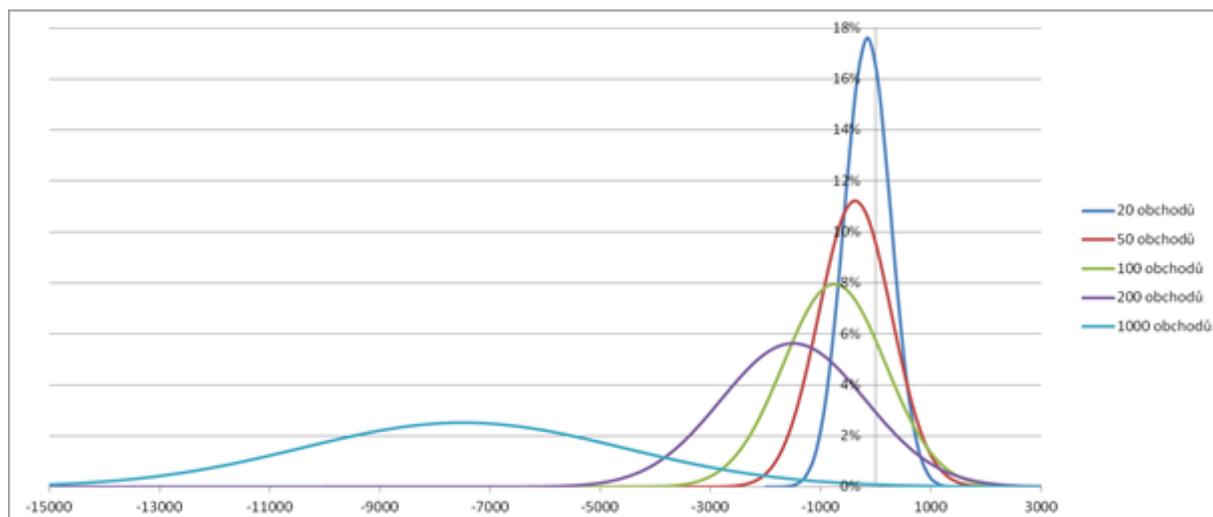
40. For the purpose of assessing how and to what extent binary options are an investor protection risk, ESMA performed an analysis of the breakdown of returns for investors.²⁶ The analysis produced two main conclusions:
 - a) High degree of risk linked to binary options;
 - b) Negative yield of ordinary binary options.
41. The general characteristic of binary options is that an investor can lose the whole amount invested very rapidly in comparison with other investment instruments, the ESMA analysis therefore confirms the high degree of the risk.
42. Problems with valuation, the binary nature of the result, the short-term nature and random trends in the value of the underlying assets over the short term in practice all lead to the conclusion that the profit or loss on ordinary binary options is a matter of chance. What has a decisive influence in such situation is the fees, and any fee means that, over a longer or shorter period, an investor will make a loss. The negative yield on ordinary binary options is a significant source of detriment for clients.
43. Further, the typically short-term character of binary options enables investors to make many transactions, one after the other. This, in combination of the expected negative yield, leads to a high probability that the more transactions an investor realises, the greater his cumulative losses will be.
44. These conclusions are illustrated by the following graph. It is a model of the probability (binomial) distribution of profit at a given number of transactions.²⁷ The probability distribution moves to the left as the number of transactions rises, which means a falling probability of making a profit as the number of transactions increases.

²⁴ Cf. parts 3.3.1 and 3.3.4 of this justification.

²⁵ Recital 19 of the preamble to Decision (EU) 2018/795.

²⁶ ESMA: *Product Intervention Analysis: Measure on Binary Options*, 2018 (accessible at www.esma.europa.eu).

²⁷ Starting points: (1) A random walk through price movements (probability of correct estimation of a price movement) - 50%, (2) a payout ratio of less than 1 (in this case 0.85 -> with an investment of 100 an investor obtains, in the event he correctly estimates trends in the value of the underlying asset, the amount of 85 over and above the initial amount, in the event he is incorrect he loses the whole initial amount), (3) the mutual independence of individual transactions (the result of one investment does not influence the result of another investment).



CNB Model. The horizontal axis shows the total yield, the vertical axis shows the probability the client will make such a profit (as a percentage).

45. The expected negative yield for an investor is usually part of the business model of the binary options provider, as it is the source of its expected income. Binary options obligate the provider of the binary option to pay the investor a fixed amount if a specified event occurs, so that the provider makes the expected profit, the investor has to suffer a loss.²⁸ This property, in particular, makes binary options structurally very similar to games of chance.
46. Specifically, for the binary options offered with continuous pricing for purchase and sale the use of this method of pricing cannot improve the expected return for the investor, as the provider of the binary option has to offer a price that enables it to make the expected profit. In reality, the expected return for investors is lower if they exit a position before an option expires than if they hold the position until expiry.
47. This combined effect illustrates a fundamental element of binary options derived from their expected negative return.
48. The conclusions of the aforementioned analysis are also confirmed by data about investors' losses stated by some competent authorities:²⁹
- An analysis by the Cypriot supervisory authority (Cyprus Securities and Exchange Commission CySEC) concerning a sample of client accounts for binary options from 10 binary options providers for the period from 1 January 2017 to 31 August 2017 found that an average of 87% of client accounts suffered a loss in the period. The average loss on an account was approx. EUR 480;
 - The Polish supervisory authority (Komisja Nadzoru Finansowego, KNF) found that in 2016 86.3% of clients suffered a loss and in 2017 86.4% of clients suffered a loss;
 - The Italian supervisory authority (Commissione Nazionale per le Società e la Borsa, CONSOB) found, based on research conducted in March 2017 that in five branches of securities brokers from other EU Member States that were active in the field of binary options Non-professional Clients in Italy investing in binary options in 2016 suffered a loss in 74% of cases, where the average loss was approximately EUR 590;

²⁸ Recital 83 of the preamble to Decision (EU) 2018/795.

²⁹ Recital 36 of the preamble to Decision (EU) 2018/795.

- d) The British supervisory authority (the Financial Conduct Authority, FCA) found that in 2016 a total of 81% to 85% of client binary option accounts were loss-making and clients' average loss was between GBP 400 and GBP 1,200.
49. According to a report of the International Organization of Securities Commissions (IOSCO), the most frequent complaints about licensed providers of speculative financial products (of which binary options are a typical example) across jurisdictions concerns the products' performance (i.e. investors' losses), the fact that clients do not understand the product or the service provided and related risks, problems with withdrawing funds after trading, aggressive or misleading marketing and manipulation of prices or transactions.³⁰
50. An analysis of the distribution of yields on binary options by ESMA and a CNB mathematical model correspond to the data of the national competent authorities, which highlights a high risk that Non-professional Clients will lose a significant part of their investment (often their whole investment), and the high risk of a negative return.³¹ These characteristics are further worsened by the general complicated nature and insufficient transparency of binary options, the marketing and distribution practices used and unavoidable conflicts of interest.
51. These negatives are not compensated for by any chance of a corresponding benefit on the client's part. The utility of binary options as a hedging instrument is fundamentally limited by their short-term nature and the fixed remuneration. In comparison with this, traditional types of options are frequently used to settle or restrict the price of an asset to which an investor is directly exposed.
52. On aggregate, the aforementioned characteristics represent an extraordinarily significant and real risk of damage to current and potential Non-professional Clients, including clients in the Czech Republic and foreign clients of Investment Firm with their registered office in the Czech Republic.

3.2.6. Extent of Potential Harmful Effects³²

53. The ESMA, based on information that it obtained from the national competent authorities, estimates that the number of trading accounts of Non-professional Clients with providers of contracts for difference and binary options settled in the EEA rose from 1.5 million in 2015 to approximately 2.2 million in 2017.³³
54. The fact that the volume and extent of trading by Non-professional Clients in binary options in the European Union was, before the prohibition against trading, non-negligible and growing is confirmed by the following information:³⁴
- a) The Cypriot supervisory authority (CY-CySEC) estimated the total number of active clients of securities traders in Cyprus investing in binary options at the end of the second quarter 2017 to be 401,378, compared to 140,205 in 2015;
 - b) The German supervisory authority (BaFin) estimated that in Germany there were up to 30,000 investors in binary options, where the total market in Germany is growing by 4–5% a year;

³⁰ Report on the IOSCO Survey on Retail OTC Leveraged Products, (FR14/2016, December 2016), pp. 46.

³¹ Recital 86 of the preamble to Decision (EU) 2018/795.

³² Article 21(2)(b) of Regulation (EU) 2017/567.

³³ Recital 33 of the preamble to Decision (EU) 2018/795.

³⁴ Recital 34 of the preamble to Decision (EU) 2018/795.

- c) The British supervisory authority (FCA) estimated that the number of clients trading with binary option providers in the United Kingdom was approximately 40,000;
 - d) A number of national competent authorities have stated that binary options are marketed and sold to a wide-ranging extent in their jurisdiction.³⁵
55. The CNB does not have data about the number of currently affected clients in the Czech Republic (services in the field of binary options are provided solely abroad). In a number of EU Member States, however, this concerns tens of thousands of clients. This high number of affected clients and the method of marketing focused on the general public confirms that they are all or mostly non-professional clients.
56. According to information from the ESMA decision³⁶, the losses of Non-professional Clients, with regard to the aforementioned arguments, are an issue for the vast majority of affected clients (usually over 80%). The amount of average losses abroad confirms that the extent of impacts on Non-professional Clients is marked. It is therefore reasonable to assume that in the event binary options are offered in the Czech Republic to a larger extent, the extent of losses by Non-professional Clients in the Czech Republic would be significant.
57. The CNB is therefore of the opinion that, from the viewpoint of the extent of potential impacts, ordinary binary options (see below for exceptions) give rise to significant investor protection concerns, both in the case of investors in the Czech Republic and in the case of foreign clients of Investment Firms with their registered office in the Czech Republic.

3.2.7. Type of Client Affected³⁷

58. Because of the complexity of binary options, it is difficult for clients to correctly understand and assess the real risk that is arising for them in connection with these products; it is extraordinarily difficult for the vast majority of Non-professional Clients.
59. In this justification the specific properties of binary options stated (regardless of small differences in contracts on binary options, see below for exceptions) show that binary options are, due to their nature, fundamentally unsuitable for Non-professional Clients, as they generate losses in the vast majority of cases.³⁸
60. The aforementioned properties of binary options concern all clients, but are significant in the case of Non-professional Clients. For the majority of Non-professional Clients, investing in binary options will not correspond to their expert knowledge and experience. As described in detail in part 3.3.8, it is Non-professional Clients to whom these options are offered and advertising campaigns in some Member States primarily target the general public.³⁹ In a number of Member States, tens of thousands of investors, i.e. the general public, invest in binary options (see part 3.3.6.).
61. The same clients can be affected in the event of the offering of binary options in the Czech Republic, or their offering by Investment Firms from the Czech Republic abroad.

³⁵ Report on the IOSCO Survey on Retail OTC Leveraged Products, (FR14/2016, December 2016), pp. 8 et seq.

³⁶ Recital 36 of the preamble to Decision (EU) 2018/795; ESMA Product Intervention Analysis: Measure on Binary Options, 2018, pp. 25.

³⁷ Article 21(2)(c) of Regulation (EU) 2017/567.

³⁸ Recital 37 of the preamble to Decision (EU) 2018/795.

³⁹ Cf., for example, a press release of the French competent authority for supervision, the AMF, “*Forex, binary options: the AMF has obtained the closure of 138 website addresses in three years*” of 4 May 2018 (accessible at www.amf-france.org).

62. In the case of professional clients (under the law and on request), on the contrary, the necessary knowledge and ability to perform informed acceptance of risks can be assumed⁴⁰ and it is not necessary to protect them with a product measure. The ESMA did not take this step and, according to the CNB's information, neither did the competent authorities in Member States.

3.2.8. Sales Techniques Used⁴¹

63. Binary options are offered most frequently to Non-professional Clients through electronic trading platforms without the concurrent provision of the investment services of investment advice or asset management for the client, with which a higher standard of suitability of an investment for a client is linked. In other cases, their provision, in accordance with Article 15i(2) of the ACMU, requires an assessment of whether a transaction in an investment instrument as a part of an investment service corresponds to the specialist knowledge and experience of the client necessary to understand the related risks, in the case of binary options such assessment is often only done formally (which is also shown by information from foreign competent authorities about real sales of binary options to a large quantity of Non-professional Clients who evidently do not understand their essence and the risks).
64. An insufficient or formal assessment of the suitability of binary options cannot prevent the providers of binary options from offering and their potential clients from entering into risky transactions or continuing with transactions. This similarly applies to an assessment of reasonability, i.e. when a client did not provide any or provided insufficient information about his knowledge and experience in the field of investment concerning a specific type of product. This occurs when, if an assessment took place in the proper manner and ended negatively, in such case the providers of binary options issue only a simple warning to a client. With regard to the conflict of interests, it is very probable that the assessment by the provider of the binary option will be distorted.
65. A common characteristic of the marketing and sales techniques used in the field of binary options is the offering of trading (monetary or non-monetary) benefits, such as bonuses, with the aim of attracting Non-professional Clients and getting them to invest in binary options. This concerns, for example, the offering of various gifts and bonuses, misleading information at seminars offered for free, the provision of apparently simple and advantageous strategies for trading, the option of trading at reduced costs (for example margins or fees)⁴² with the aim of motivating the client to trade more actively in the product and drawing attention away from the product's disadvantageous nature.
66. Bonuses and other trading benefits can draw attention away from the highly risky nature of a product. They are usually targeted so that they attract Non-professional Clients and get them to trade. Non-professional Clients may regard such advertised offers as so attractive that, with the aim of obtaining them, they proceed to trade without paying sufficient attention to the high risk that is linked to binary options.
67. The use of bonus systems draws inspiration from online gambling. Some providers marketing the relevant products offer "welcome bonuses" (for opening an account) and bonuses based, for example, on amounts invested.

⁴⁰ Recital 37 of the preamble to Decision (EU) 2018/795.

⁴¹ Article 21(2)(j) of Regulation (EU) 2017/567.

⁴² Recital 43 of the preamble to Decision (EU) 2018/795.

68. Based on the information contained in the ESMA decisions⁴³, the CNB regards it as having been confirmed that the quality of information provided to Non-professional Clients (for example at the providers' websites) is low, advertising communications focus on information about how binary options work and most frequently their aim is to give rise to interest in speculative trading with the dream of a high profit for clients (in a similar manner to games of chance) and not to provide the information necessary for a responsible decision by a Non-professional Client.⁴⁴
69. Investment Firms are obligated to provide fair, clear and not misleading information in accordance with Article 24(3) of MiFID II.⁴⁵ Despite this, they often use techniques to attract clients that do not reflect the suitability of binary options. Aggressive marketing and sales techniques that are not in the best interests of the Non-professional Client are standard practice.⁴⁶
70. This concerns the contents of websites or information stated in a language that is not the national language of the Member State in which the services are provided or stated in the national language based on translations of insufficient quality, so it is probable that the information presented could be incorrectly understood.
71. Information about binary options is presented in such a manner that great emphasis is placed on possible benefits related to investment, without the relevant risks being stated in a fair and clear manner, which gives rise in retail clients to the impression that binary options are suitable for all investors or that making a profit on them is easy.⁴⁷
72. The aforementioned marketing and distribution practices related to binary options are linked to the offering of ordinary binary options (with the exceptions from the prohibition see below) in a number of European Union Member States and there is reason to believe that there is a risk of a greater expansion of binary options in the Czech Republic.

3.2.9. Possible Endangering of Investors' Trust in Financial System⁴⁸

73. The combination of the marked complexity and insufficient transparency of ordinary binary options, the product's expected negative return for Non-professional Clients, the lack of rational reasons for investing in the instrument, often misleading and aggressive marketing and distribution, providers' conflicts of interest and the extent of possible unfavourable consequences all contribute to Non-professional Clients losing significant amounts and, as a consequence of this, losing trust in the financial system.
74. With regard to the high probability that clients will suffer a loss, Non-professional Clients that are not experienced in investing on the capital market or have only insufficient experience of this and that were attracted by aggressive marketing by binary option providers could reach the conclusion that such products were a representative sample of financial (investment) instruments.
75. This fear is strengthened by the high number of Non-professional Clients in some Member States and the number of complaints concerning these products, as can be seen from the IOSCO report on the IOSCO survey of speculative retail OTC products.⁴⁹

⁴³ ESMA (EU) Decision 2018/795 of 22 May 2018, ESMA (EU) Decision 2018/1466 of 21 September 2018, ESMA (EU) Decision 2018/2064 of 14 December 2018, ESMA (EU) Decision 2019/509 of 22 March 2019.

⁴⁴ For example, recital 48 of the preamble to Decision (EU) 2018/795.

⁴⁵ In the Czech legal order transposed into Article 15(6) and Article 15a(1) of the ACMU.

⁴⁶ Recitals 44 and 46 of the preamble to Decision (EU) 2018/795.

⁴⁷ Recital 48 of the preamble to Decision (EU) 2018/795.

⁴⁸ Article 21(2)(v) of Regulation (EU) 2017/567.

3.3. Interpretation of Condition “in at least one Member State”

76. In accordance with Article 42(2)(a)(i) of MiFIR, a measure can be implemented if the instrument (or activity or practice) under assessment gives rise to significant investor protection concerns in at least one Member State.
77. Based on its supervisory activities, the CNB is not aware of binary options being offered by entities to which the CNB has granted securities traders' licenses. Nevertheless, an analysis indicates that binary options give rise to significant investor protection concerns in every Member State where they have been offered (see Part 3.2). The nature of the threat described in the other parts of the justification is such that they could undoubtedly endanger clients in the Czech Republic, and a preventative measure is therefore justified.
78. When performing supervision, the CNB cannot monitor only the limited interest of investors in the Czech Republic, but also, based on the principle of loyalty and in accordance with a directly-applicable regulation (Article 42(1) of MiFIR), it has to take into consideration the protection of investors in other Member States that could be affected by the offering of binary options from the Czech Republic. The CNB also refers to recital 48 of the preamble of MiFIR, according to which the overall impact of problems related, inter alia, to prohibitions against products and practices can only be fully understood in a Union-wide context. So the condition “in at least one Member State” is therefore met.

3.4. Insufficiency of Current Regulatory Requirements

79. In accordance with the requirement of Article 42(2)(b) of MiFIR, the CNB considered whether the aforementioned threat is dealt with by current regulatory requirements in accordance with European Union legal regulations applicable to binary options. The applicable requirements are applied at the level of European Union law by MiFID II, MiFIR and Regulation (EU) No 1286/2014 of the European Parliament and of the Council.⁵⁰ This primarily concerns:
- a) The requirement to provide clients with the relevant information in accordance with Article 24(3) and (4) of MiFID II (transposed into Article 15a(1), Article 15(6) and Article 15d(1) to (5) of the ACMU);
 - b) The requirement to assess the suitability and appropriateness of investments for the client in accordance with Article 25(2) and (3) of MiFID II (transposed into Article 15h and Article 15i of the ACMU);
 - c) The requirement for the best method of executing orders in accordance with Article 27 of MiFID II (transposed into Article 15l(1) to (6), Article 15m, Article 15n(1) to (5), Article 15r(1) to (5), Article 731 of the ACMU);
 - d) The product management requirements in accordance with Article 16(3) and Article 24(2) of MiFID II [transposed into Article 7(5), Article 8(5), Article 12, Article 12a(1)(b) to (e), (h), (i), (l), Article 12a(2) to (3), Article 12d, Article 12ba(1) to (3) and (5) to (6), Article 12bb, Article 13, Article 12e(1) to (2), Article 15a(3) to (5), Article 15b, Article 17(1) to (4)(a) and (b) and (5), Article 24(5)(a), (c) and (e) of the ACMU];

⁴⁹ Report on the IOSCO Survey on Retail OTC Leveraged Products, pp. 46 (FR14/2016, December 2016) (accessible at www.iosco.org).

⁵⁰ Regulation (EU) No 1286/2014 of the European Parliament and of the Council of 26 November 2014 on key information documents for packaged retail and insurance-based investment products (PRIIPs).

- e) The requirements for ascertaining and managing a conflict of interests in accordance with Article 12(b) of the ACMU and Article 33 to 43 of Regulation (EU) 2017/565;
 - f) The requirements concerning the publication of information in accordance with Articles 5 to 14 of Regulation (EU) No 1286/2014.
80. With regard to the fact that Article 42(2)(b) of MiFIR refers to the sufficiency of EU rules, the CNB, in the remainder of the text, states references to the relevant EU legislation, including directives, not to binding Czech regulations. The rules stated in directives (specifically in MiFID II) were fully transposed and apply in the Czech Republic, as is illustrated by the summary stated in the previous paragraph.

Requirement to Provide Clients with Relevant Information

81. Upon the passing and implementing of MiFID II (the transposition was performed by an amendment to the ACMU, No. 204/2017 Coll., with effect from 3 January 2018), there was a marked expansion of the duty of Investment Firms, i.e. in accordance with the ACMU securities traders, in the area of publication of information about costs and fees. Nevertheless, rules based on the provision of information, including better information about costs, of themselves, are not sufficient to deal with the complicated risk linked to marketing, distribution and sale of binary options to Non-professional Clients.
82. Specifically, Article 24(3) of MiFID II, inter alia, requires that binary options providers ensure that all information, including promotional communications for clients or potential clients, are fair, clear and not misleading. Article 24(4) of MiFID II also requires that a binary options provider provides clients or potential clients, a sufficient time in advance, with the relevant information about the binary options provider and its services, financial instruments and proposed investment strategies, places of execution and all costs and related fees, in particular including instructions and warnings concerning risks related to investments in such instruments and information about whether an investment instrument is for non-professional or professional clients.
83. Greater transparency in connection with the execution of orders helps clients better understand and assess the practices of a binary options provider in the area of execution of orders and therefore better assess the quality of overall services that are provided to them. In addition to this, better information about how binary options providers execute clients' orders helps clients when monitoring whether a binary options provider took sufficient measures to ensure it achieved the best possible result for a client.
84. Based on a description of the investor protection concerns in connection with binary options (in particular their complexity, riskiness and expected negative yield), it is clear that damage to investors cannot be fully and properly prevented only by applying these rules. This type of publication of information does not sufficiently draw clients' attention to the specific consequences (the almost certain negative yield) of investing in the aforementioned instruments and does not deal with the concerns related to the properties of binary options.
85. The CNB also considered the importance of rules concerning the publication of information in Regulation (EU) No 1286/2014. This regulation sets out uniform rules governing the format and content of the statement of key information that has to be provided by providers of structured retail investment products and insurance products with an investment element (hereinafter "Products with an Investment Element") to Non-professional Clients with the aim of enabling them to understand the main characteristics

of a Product with an Investment Element and the related risks and compare it to other products. In particular Article 8(3)(d) of Regulation (EU) No 1286/2014 and other implementing provisions contained in Regulation (EU) 2017/65⁵¹ stipulate, inter alia, the methodology for presenting an aggregate risk indicator and accompanying explanations, including whether a Non-professional Client can lose all capital invested or whether he could be obligated to settle other financial obligations.

86. This type of aggregate publication of information, however, does not sufficiently inform Non-professional Clients of all the consequences of investing in binary options. The creator of a product, for example, is not obligated, as a part of the performance indicator, to state information about the total percentage of accounts of Non-professional Clients that have suffered a loss or the probability of occurrence of individual performance scenarios.
87. The publication of information, in addition, is not sufficient in the case of instruments that are themselves too complex, risky and unsuitable for Non-professional Clients.

Requirement of Assessing Suitability and Appropriateness of Investment for Client

88. The requirements concerning suitability were also strengthened in MiFID II, as far as concerns the provision of information about suitability for a client and a specification of the assessment of suitability. Specifically, Article 25(2) of MiFID II requires that binary options providers obtain the necessary information regarding a client's or potential client's knowledge and experience, inter alia, in the investment field relevant to the specific type of product, that person's financial situation including his ability to bear losses, and his investment objectives, including his risk tolerance, so as to enable the binary options provider to recommend to the client or potential client the investment instruments that are suitable for him and are in accordance with his risk tolerance and ability to bear losses. The requirements concerning suitability, however, only apply to the provision of investment advice and asset management for a client. Therefore they are usually not significant for binary options providers in connection with the marketing, distribution or sale of binary options, which mostly takes place over electronic platforms without the provision of investment advice or asset management for a client.
89. The aims of an assessment of suitability (assessment of products with regard to clients' knowledge and experience, their financial situation and investment aims) remained basically unchanged compared to the regime in Directive 2004/39/EC⁵² and, as is shown by the information in the justification for this measure and in the ESMA Decision,⁵³ they are not sufficient to prevent damage to investors.
90. The requirements concerning an assessment of the suitability of an investment for a client were strengthened in MiFID II in a similar manner, in particular by narrowing the list of simple instruments and therefore by limiting the extent of instruments for which it is possible to provide the investment service of execution or handover of an order without

51 Commission Delegated Regulation (EU) 2017/653 of 8 March 2017 supplementing Regulation (EU) No 1286/2014 of the European Parliament and of the Council on key information documents for packaged retail and insurance-based investment products (PRIIPs) by laying down regulatory technical standards with regard to the presentation, content, review and revision of key information documents and the conditions for fulfilling the requirement to provide such documents.

52 Directive 2004/39/EC of the European Parliament and of the Council of 21 April 2004 on markets in financial instruments amending Council Directives 85/611/EEC and 93/6/EEC and Directive 2000/12/EC of the European Parliament and of the Council and repealing Council Directive 93/22/EEC (hereinafter referred to as "MiFID I").

53 Recital 60 of the preamble to Decision (EU) 2018/795.

performing a suitability or appropriateness test. Binary options are complex investment products, and therefore they should always be the subject of a full assessment of appropriateness in accordance with Article 25(3) of MiFID II. Article 25(3) of MiFID II requires that binary options providers ask their clients or potential clients to provide information regarding that person's knowledge and experience in the investment field, inter alia, in connection with the specific instrument offered or demanded so as to assess whether the instrument envisaged is appropriate for the client or potential client. If, however, a binary options provider thinks that a product is not appropriate for a client or potential client, it only provides a simple warning.

91. The above parts of the justification indicate that the requirements for an assessment of suitability and an assessment of appropriateness in connection with valid legal regulations do not prevent significant losses on the part of clients, in particular non-professional ones, i.e. significant investor protection fears were and still are appropriate.

Requirement for Best Execution of Orders

92. As far as concerns the best execution of orders, Article 27 of MiFID II stipulates that a binary options provider must take "all sufficient steps" to obtain, when executing orders, the best possible result for their clients. Market participants, in addition, must publish supplementary information and, in particular, binary options providers are obligated to publish the five best places for executing orders where they executed clients' orders and the results they achieved when executing the aforementioned orders.
93. The CNB considered whether new rules concerning the best execution of orders could resolve, at least, the some concerns related to the marketing, distribution or sale of binary options to Non-professional Clients. Requirements concerning the best execution of orders, inter alia, strengthen the standard of execution of orders, as they require that binary options providers check the appropriateness of a price proposed to a client when executing orders or deciding on trading, including instruments created at the client's request. The requirements of MiFID II imply the gathering of market data used for an estimate of the price of an instrument and, if possible, a comparison with similar or comparable instruments.
94. These requirements therefore have the potential to reduce the costs of trading in binary options (and therefore increase the accessibility of binary options), but they do not have an impact on their complexity or on the low probability of a profit by the client, as with regard to the in practice random trends in short-term options any fee is a decisive factor (the same as in a casino). It therefore does not deal with the risks related to characteristics of an instrument other than the execution of orders.

Product Management Requirements

95. The CNB considered the impact of the new rules concerning product management that were stipulated in Article 16(3) and Article 24(2) of MiFID II. The aforementioned rules require that providers creating financial or investment instruments (including binary options) for sale to clients ensure that such investment instruments are designed in such a manner to meet the needs of the designated target market of end clients in the relevant client category, that the strategy for the distribution of such products is in accordance with the designated target market and that binary options providers take appropriate steps with the aim of ensuring that investment instruments will be distributed on the designated target market and regularly review the identification of the target market and product

performance. Binary options providers must understand the investment instruments that they are offering or recommending, assess the compatibility of such instruments with the needs of clients to whom they provide investment services, also with regard to the designated target market of end clients, and ensure that the investment instruments are offered or recommended only if it is in the client's interest.

96. In addition to this, binary options providers that distribute an investment instrument that they did not create must have suitable systems implemented to obtain and understand the relevant information concerning the product approval procedure, including the designated target market and product properties. Binary options providers distributing investment instruments created by other persons to which the product management requirements stipulated in MiFID II do not apply must also have suitable systems to obtain additional information about such financial instruments.⁵⁴
97. The purpose of the MiFID II product management requirements is to narrow the type of clients (define the target market) for which financial instruments are suitable and to which they should be distributed. With regard to the properties of binary options (high rate of losses, expected negative yield, short-term contracts, complex structure of prices and general lack of reasonable investment aims), however, in the CNB's opinion it is not possible to determine any retail target market for such binary options, or rather all Non-professional Clients should be in the negative market, i.e. the group of persons to which such instrument should not be offered at all. In other words, it is not possible to design binary options suitable for the retail market, as this is prevented by the essence of binary options (see below for exceptions from the prohibition).
98. In addition to this, Article 21(2)(c), fifth bullet point, of Regulation (EU) 2017/567 states as among the facts that should be taken into consideration when considering product interventions, "whether the product or service is being sold to clients outside the intended target market or where the target market has not been adequately identified", i.e. it expressly assumes that the existence of product management rules or non-compliance with such rules does not prevent the application of Article 42 of MiFIR and, on the contrary, could be one of the reasons for its application.

Summary of Insufficiency of Current Regulatory Requirements

99. Despite the aforementioned regulatory requirements, Non-professional Clients keep losing their invested money on binary options and there is a significant and justified concern that without the adoption of a prohibition they will continue to lose it.⁵⁵ The current requirements of MiFID II and other regulations are therefore not sufficiently effective to deal with the stated threat.
100. With regard to the properties of ordinary binary options, where they are basically bets on the value (level) of the underlying asset at a given moment (usually a very short time after the opening of a position), it is a product that is markedly disadvantageous for clients. It is also necessary to emphasize the marked conflict of interests of a binary options provider who is the counterparty in a transaction. This type of instrument should not be offered to clients at all as a financial (investment) instrument and should be regulated as a game of chance. Current regulatory requirements on the financial market are not for the regulation of products whose nature corresponds to a lottery or other similar game.

⁵⁴ Recital 67 of the preamble to Decision (EU) 2018/795.

⁵⁵ Recital 70 of the preamble to Decision (EU) 2018/795.

101. With regard to the fact that the requirements of EU (and Czech) legal regulations do not sufficiently deal with the aspects stated here, they cannot be dealt with by perfected supervision in accordance with Article 42(2)(b) of MiFIR (“and the issue would not be better addressed by improved supervision or enforcement of existing requirements”). Effective punishment, in the event of a breach of the rules, occurs *ex post* and does not lead to compensation for a loss suffered by a client. The threat of high monetary fines or the removal of a license from a binary options provider does not represent a deterrent that could prevent the offering of binary options to Non-professional Clients where it is a form of certain profit for binary options providers and the corresponding expected losses for Non-professional Clients. The only effective way of preventing such expected losses on the part of Non-professional Clients is to adopt a prohibition.

3.5. Exception for Some Binary Options

102. Nevertheless, the reasons for the issue of this measure do not concern all types of binary options, and therefore not all binary options are covered by this measure’s remit. Instruments meeting the conditions stipulated in Section III of the measure of a general nature are exempted from this measure of a general nature.
103. The first exception concerns binary options where the client obtains at least the amount input back. Such instruments are not linked to risks of negative yields or the other risks described above. It is not clear whether such options are offered on the Czech market, but if they were, they would hardly give rise to significant investor protection concerns.
104. It also concerns types of binary options that are sufficiently long-term, for which a prospectus was issued (i.e. they are securitized) and where the binary options provider or another entity in the group a member of which is the binary options provider is fully hedged against the risk resulting from the binary options. Even in this case it is not probable that they would give rise to significant client protection concerns or that reasons for such concerns would be found.⁵⁶
105. The measure assumes that it could be a prospectus in accordance with the ACMU or (in particular in the case of services that would be provided in the Czech Republic) a comparable foreign regulation governing the publication of a prospectus during a public offer of securities or their acceptance on the regulated market. From 21 July 2019 new provisions on prospectuses will apply in the European Union, in accordance with Regulation (EU) 2017/1129 of the European Parliament and of the Council on the prospectus to be published when securities are offered to the public or admitted to trading on a regulated market, and repealing Directive 2003/71/EC.
106. Although the degree of complexity of this specific type of binary options is comparable with the degree of complexity of binary options in general, the requirement for a minimum period of validity fundamentally limits the negative impacts for Non-professional Clients. Clients can, during a period of 90 or more days from the first issue of the relevant instrument, more easily make an informed judgement about the market than in the case of a very short period of validity typical for otherwise ordinarily offered and traded binary options. The time period of 90 days or more also markedly limits the space for frequently repeated speculative transactions that deepen losses and are an expression of addicted behaviour. Currently, the structure of costs for Non-professional Clients limits the risks related to the usual model of binary options.⁵⁷

⁵⁶ Recitals 20 and 8 of the preamble to Decision (EU) 2018/1466.

⁵⁷ Recitals 12 and 18 of the preamble to Decision (EU) 2018/1466.

107. With regard to these facts, the CNB decided in accordance with Article 42(1), last sentence, of MiFIR (“A prohibition or restriction may apply in circumstances, or be subject to exceptions, specified by the competent authority”) that it will not apply the prohibition to these binary options.

3.6. Scope of Measure of a general nature

108. The first sentence of Article 42 of MiFIR states “A competent authority may prohibit or restrict the following in or from that Member State.” A measure can therefore have (i) a purely domestic scope (impact all Investment Firms that offer a certain financial instrument in the Czech Republic, including those offering cross-border investment services), or (ii) target an offer of a financial instrument from the Czech Republic to another country (in particular European Union and European Economic Area Member States), or (iii) cumulatively set out a prohibition or restriction for both cases.

109. The CNB, in accordance with Article 2 of Act No. 15/1998 Coll., on supervision of the capital market and on the amendment and supplementation of other acts, as amended (hereinafter the “Supervision Act”), when performing supervision of the capital market strengthens investors’ trust in the capital market, in particular by contributing to investor protection and the development of the capital market and by supporting education in this field.

110. At the same time, it is necessary to refer to investor protection in the EU and the principle of loyalty to other Member States, which is the basis of the power in accordance with Article 42 of MiFIR and also results from Article 2 of the ESMA Directive.

111. With regard to this, it is also necessary to prevent the offering of binary options in the Czech Republic and from the Czech Republic.⁵⁸

3.7. Proportionality of Measure

112. In accordance with Article 42(2)(c) of MiFIR, a product intervention can be adopted if it is “proportionate taking into account the nature of the risks identified, the level of sophistication of investors or market participants concerned and the likely effect of the action on investors and market participants who may hold, use or benefit from the financial instrument”

113. The CNB, in agreement with ESMA, believes that all the options set out by legally binding and non-binding instruments have been exhausted in this field.⁵⁹ In February 2014 ESMA issued an opinion on procedures in accordance with MiFID II for Investment Firms selling complex instruments⁶⁰ and in March 2014 it issued an opinion concerning structured retail products – tried-and-tested procedures for mechanisms for product management.⁶¹ Other warnings were issued by the competent authorities of Member States, including the CNB.

⁵⁸ ESMA-35-43-1776 (AFM), ESMA-35-43-1797 (KNF), ESMA-35-43-1811 (FCA) of 26 March 2019 (accessible at www.esma.europa.eu).

⁵⁹ Joint Opinion of European Supervisory Authority *Manufacturers' Product Oversight and Governance Processes* (JC-2013-77) (accessible at www.eiopa.europa.eu).

⁶⁰ ESMA Opinion *MiFID practices for firms selling complex financial products* of 7 February 2014 (ESMA/2014/146) (accessible at www.esma.europa.eu).

⁶¹ ESMA Opinion *Structured Retail Products - Good practices for product governance arrangements* of 27 March 2014 (ESMA/2014/332). (accessible at www.esma.europa.eu).

114. Despite the requirements of legal regulations described above and the aforementioned warnings, Non-professional Clients continued to suffer marked losses in connection with the marketing, distribution or sale of binary options.
115. Less restrictive steps were considered at the CNB (the same as before in ESMA), such as:
- a) The duty to sell and distribute ordinary binary options through advisory services. Nevertheless, what was stated above applies - that the majority of binary options are, with regard to their essence and properties, essentially disadvantageous for Non-professional Clients and an instrument that causes them losses. On the contrary, where it is possible to allow the offering of some binary options with regard to their nature (transparency, cost, long-term nature), there is an exception from the prohibition.
 - b) A minimum period of validity for binary options. The main fears related to this product would not change based on the measure itself. In particular, the structure of binary options means an expected negative yield for retail investors, without this being compensated for by any clear benefit (for example the hedging function that traditional options perform).⁶² On the contrary where there is long-term validity of binary options and other conditions are met, there is the option of offering them to Non-professional Clients.
116. The CNB performed the division of binary options into those that, based on available information, give rise to investor protection concerns and those that do not give rise to such concerns and for which the current instruments are sufficient, according to available information. For such binary options there is a justified exception from the prohibition against offering (see Part 3.5 of the justification).
117. The prohibition also does not affect professional clients, who have a greater ability to assess the risky nature of an investment and are better able to assess the properties of financial products. The aforementioned group of professional clients includes natural persons that have sufficient knowledge and experience so that they can be classified as a professional client at their own request.⁶³
118. With regard to the nature of binary options (with the aforementioned exceptions) and the ascertained significant threat to investor protection, the CNB, in agreement with ESMA, is of the opinion that it is necessary and therefore reasonable to prohibit the marketing, distribution or sale of binary options to Non-professional Clients. This prohibition deals with the threat by providing a reasonable and uniform standard of protection for Non-professional Clients investing in binary options from and in the Czech Republic. The prohibition does not have a damaging effect on the efficiency of the financial markets, investment service providers or investors that would be unreasonable with regard to the benefit of the measure. In accordance with Article 42(6) of MiFIR, the CNB will cancel this measure if the conditions stated in Article 42 of MiFIR cease to apply.
119. Reference can also be made to the benefits that outweigh any unfavourable impact of the measure on affected binary options providers.

⁶² Recital 91 of the preamble to Decision (EU) 2018/795.

⁶³ See Article 2b of the ACMU. This concerns a person that meets two of the following three criteria, at least: (1) In the last year he performed transactions in the relevant area of the financial market with an investment instrument in a significant volume – on average at least 10 transactions a quarter, (2) the volume of investment assets of such person is equal to EUR 500,000, (3) at least one year's experience on the financial market, requiring knowledge of transactions or services. (Transactions and experience are always assessed in relation to a certain type of instrument).

- a) A significant reduction in the risk of brokering of unfavourable products for Non-professional Clients and related financial consequences, which is a significant benefit for them and a benefit for the financial market as a whole;
 - b) A reduction in the risks related to regulatory arbitrage for various entities and in various jurisdictions.
120. This is because the CNB thinks that an intervention measure prohibiting the marketing, distribution or sale of binary options (regardless of whether they are traded in a trading system or not) is necessary to deal with risks concerning protection of Non-professional Clients.

3.8. Prohibition against Discrimination against Providers from Other European Union Member States

121. In accordance with Article 42(2)(e) of MiFIR, a measure adopted cannot have “a discriminatory effect on services or activities provided from another Member State.” The prohibition against discrimination results also from other regulations and is included in the principles supporting the rule of law.
122. The CNB is of the opinion that, with regard to the product measures described above implemented by the ESMA⁶⁴, binary option providers have already adapted their business and could focus what they offer on other financial instruments and products.
123. The measure issued by the CNB is, in addition, in terms of the content and extent, identical to forthcoming similar product measures in other Member States⁶⁵ and its scope relates to the offering of binary options in the Czech Republic by all Investment Firms, including those that are not subject to CNB supervision. This means that this measure cannot have a discriminatory effect on services or activities provided from another Member State.

4. COMPLIANCE WITH PROCEDURAL CONDITIONS FOR ISSUE OF MEASURE IN CZECH REPUBLIC

124. In accordance with Article 42(2)(d) of MiFIR, a measure implemented should be properly discussed with the competent authorities in other Member States that such measure could affect. In accordance with Article 42(3) of MiFIR, such measure must be notified at least a month in advance to all competent authorities and ESMA.
125. The CNB called, in the form of an electronic communication through ESMA, on the competent authorities in other Member States to make a statement on such notified intention within 15 days. The CNB regards this procedure as proper consultation and in this manner the CNB contacts the other competent authorities in other Member States in this matter. CNB did not receive any reaction from concerned national competent authorities.
126. The CNB also made a notification in accordance with Article 42(3) of MiFIR. Based on this notification, ESMA issued opinion on product intervention in relation to binary

⁶⁴ Cf. part 2 of the justification.

⁶⁵ ESMA-35-43-1776 (AFM), ESMA-35-43-1797 (KNF), ESMA-35-43-1811 (FCA) of 26 March 2019 (accessible at www.esma.europa.eu).

options proposed by the Czech National Bank (ESMA35-43-1967) dated 5 June 2019. ESMA concluded to consider the proposed measure as justified and proportionate.⁶⁶

127. In accordance with Article 42(2)(f) of MiFIR, a measure adopted should be discussed with “*public bodies competent for the oversight, administration and regulation of physical agricultural markets under Regulation (EC) No 1234/2007.*”
128. The CNB identified the Ministry of Agriculture of the Czech Republic as the public entity competent for the oversight, administration and regulation of physical agricultural markets. On 24th of April 2019, the CNB invited the Ministry of Agriculture of the Czech Republic to comment on the prohibition of marketing, distribution and sale of binary options to other than professional clients from and in the Czech Republic. Using this procedure, CNB fulfilled its obligation to consult draft measures of a general nature with potentially affected authorities pursuant to Section 172(1) of the Administrative Code. The Ministry of Agriculture of the Czech Republic did not comment on this intention.
129. A draft of this measure of a general nature was published from 13th of May 2019 to 30th of May 2019 in a manner enabling remote access in accordance with Art. 172(1) of the Administrative Code in connection with Art. 199(6) of ACMU.
130. CNB invited the persons concerned to file their written comments in respect of the proposed measure in the public notice on the issuance of a measure of a general nature. Nobody answered to such invitation, and CNB did not receive any comment from concerned person in the period of 15 days.
131. The CNB has not identified any reasons for the amendment of the draft measure of a general nature even from its own activities and, it is being issued unchanged from the original draft following the necessary procedural steps.
132. It is not possible to submit a remedy against a measure of a general nature in accordance with Article 173(1) of the Administrative Code.

Effect

This measure of a general nature will become effective 2nd of July 2019.

signatures and stamp of ČNB

Marek Mora
Deputy Governor

Vojtěch Belling
Executive Director, Regulation and
International Cooperation Department

This measure of a general nature was published on 18th of June 2019.

⁶⁶ Opinion of the European Securities and Markets Authority of 5 June 2019 on the product intervention measure relating to binary options proposed by the Česká národní banka of the Czech Republic, s. 4: „*In conclusion, ESMA is of the opinion that: the national measure is justified and proportionate (...)*“.