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Delivery Via Email: consultation-en-cours@lautorite.qc.ca; comments@osc.gov.on.ca

Alberta Securities Commission
Autorité des Marchés Financiers
Financial and Consumer Services Commission (New Brunswick)
Financial and Consumer Affairs Authority of Saskatchewan
Manitoba Securities Commission
Nova Scotia Securities Commission
Nunavut Securities Office
Ontario Securities Commission
Office of the Superintendent of Securities, Newfoundland and Labrador
Office of the Superintendent of Securities, Northwest Territories
Office of the Yukon Superintendent of Securities
Superintendent of Securities, Department of Justice and Public Safety, Prince Edward Island

Me Anne-Marie Beaudoin
Corporate Secretary
Autorité des Marchés Financiers
800, rue du Square-Victoria, 22e étage
C.P. 246, tour de la Bourse
Montréal, Québec H4Z 1G3

Grace Knakowski
Secretary
Ontario Securities Commission
20 Queen Street West, 22nd floor
Toronto, Ontario M5H 3S8

Re: Proposed National Instrument 91-102 “Prohibition of Binary Options” and Related Proposed Companion Policy (the “Proposed Rules”)

The Investment Industry Association of Canada (IIAC) would like to submit its comments regarding the Proposed Rules on binary options trading.

The IIAC and its Mandate

The IIAC is the national association representing the position of 130 IIROC-regulated Dealer Member firms on securities regulation, public policy and industry issues. We work to foster a vibrant, prosperous investment industry driven by strong and efficient capital markets.

Current Issue

There is currently an issue concerning binary options trading. It is important for the Canadian Securities Administrators (“CSA”) to consider this matter.

Certain investors currently trade binary options on illegal electronic platforms, operated by individuals who have not been approved by regulatory organizations and who have not obtained prior authorization to trade those derivative products. The publication of warning notices by regulatory organizations is evidence of the seriousness of this issue, but regulators, despite their best efforts, seem to be unsuccessful in putting an end to the problem.

As will be mentioned below, we believe that this trading activity to retail investors must be regulated by Canadian regulators to ensure the protection of the public against unfair, abusive and fraudulent practices, including the risk of diversion of funds outside of Canada. We believe that brokers regulated by the Investment Industry Regulatory Organization of Canada (“IIROC”) should be allowed to offer binary options to retail investors to prevent these individuals from fraudulent trading.

In addition, certain investors mistake the current unlawful activity for that of regulated brokers in Canada. The reputation of our industry is, therefore, indirectly at stake.

Legal trading vs. Fraud

It should be stressed that there are two types of “trading” currently occurring in Canada:

1. Institutional and sophisticated investors trading binary options legally;
2. Investors using fraudulent online platforms to be scammed out of their money.

We believe the proposed rules could potentially disrupt “legal” binary options trading currently executed by our members without preventing the “scamming” performed by fraudsters.

Legal trading: Binary Options and Their Use in our Industry

Binary options are not the problem, per se. Their structure, as well as their mechanism, is simple.

Binary options are often referred to as digital or all-or-nothing options. Binary options can also be listed on renowned markets such as the Chicago Board Options Exchange. Institutional and sophisticated investors (including closely held corporations) use them in order to increase the returns on their investments while taking on the risks involved. The issue we are currently facing is not related to binary options per se, but is a problem of another nature.

Illegal trading: Illegal Platforms and Fraudsters

As mentioned above, the industry's concerns are not on the structure of binary options, but rather on the way in which they are offered to investors by fraudsters. The issue lies with the offers made illegally by individuals who are not registered and not authorized under applicable laws. No issues lie with the "legal" binary options trading executed by institutional or sophisticated investors.

Illegal online trading sites (often based abroad) provide incorrect information to investors and indicate that there is no risk involved in the transactions performed on their electronic platforms. The fraudsters behind these platforms manipulate the price of the underlying securities in order to "win" against the investor. In certain cases, investors could "win," but they will rarely receive the profit earned. In the latter case, the counterparty risk is related to the settlement of the product by fraudsters. The fact that there is no central clearing poses a major risk of fraud for individuals. The increase in the number of complaints made by clients who have lost their capital is evidence of this problem.

In addition, these trading sites are not registered with regulatory organizations and the individuals operating them are not registered as derivatives brokers or members of a self-regulating body and of an investor protection fund. Considering the illegality of these activities with derivatives in Canada, not to mention the risk of unfair, abusive or fraudulent practices for the investing public, it is essential for the CSA to ensure the enforcement of its regulations on derivatives by specific measures aimed at suppressing these violations. Certain fraudulent operation sites even indicate, incorrectly, that they are registered with regulatory organizations. These websites must be shut down.

We further believe that the RCMP must be involved in stopping these international fraudsters. The RCMP should shut down these sites and try to prosecute these criminals with the help of international law enforcement agencies.

Proposed Rules and their Impact

We see certain issues with the Proposed Rules. For example, the definition of a “binary option” in the Proposed Rules should be amended as it currently covers legitimate binary option transactions executed by institutional and sophisticated investors.

More importantly, since these electronic trading platforms are operated by fraudsters, we doubt they would chose to comply with the Proposed Rules if they were implemented. Therefore, the Proposed Rules will not end the illegal activity and may interfere with the current “legal” institutional binary options trading taking place in the Canadian market.

We also note that Section 3 proposes to prohibit retail investors from circumventing a trading ban by establishing a company or trust for the purpose of trading binary options. We believe that any retail investor that will have the means to create a company or a trust in order to circumvent a trading ban should be considered a sophisticated investor. No protection would be needed for this type of individual. We therefore believe that Section 3 of the Proposed Rules should be removed.

Binary Options Transactions through Regulated Firms

In order to end illegal transactions, regulatory organizations must consider the possibility of allowing IIROC-regulated brokerage firms to be registered to offer these products to all investors. Furthermore, regulators must correctly define binary options to avoid confusion in the industry.

Dealing with an IIROC-regulated firm will allow investors who wish to trade binary options to properly understand the product as well as the significant risks involved. Furthermore, there would be no risk of fraud in regulated and legal trading as is present on illegal trading platforms.

We also believe that since our members are IIROC-regulated brokers, they should be exempt from the application of the Proposed Rules if they can offer binary options to retail investors.

IIROC and the CSA: Informing the Investor

As it is IIROC’s mission to protect the investor, legal and regulated binary options trading will be beneficial to experienced investors seeking this kind of product. The IIROC strict regulatory framework would allow clients to gain an understanding of this kind of product through disclosure obligations before a transaction is executed. In addition, clients of full-service firms will be protected by the concept of investment suitability.

We also believe that it is essential for the CSA to keep informing the investing public about the fraud occurring on illegal trading platforms in order to stop the criminals. The CSA must also warn investors about the “Scammed by binary options? We help recover your money” scam created by these criminals.

Conclusion

The IIAC and its members urge the CSA to prevent illegal binary options trading in order to protect investors and contribute to the integrity of our industry. We believe this must be done by allowing IIROC-regulated brokers to offer binary options and not through the Proposed Rules. As previously mentioned, we highly doubt that the criminals would comply with these rules.

As mentioned above, binary options are not the problem. The fraudulent and illegal trading of this product is the issue and must be stopped.

Regulatory bodies must consider the possibility of registering certain regulated firms to trade this product legally, with no risk of fraud, and with a strict regulatory framework to protect Canadian investors.

We believe investor education and warnings must continue in order to stop the illegal and fraudulent binary option activity in Canada. The only way to prevent online fraud is the tell Canadians about this “trading” scam as well as the related “we help recover your money” scam.

Furthermore, we believe that international law enforcement agencies must work together to stop these criminals.

Please note that the IIAC and its Members, as always, remain available for further consultations.

Yours sincerely,



Annie Sinigagliese
Managing Director
Investment Industry Association of Canada
asinigagliese@iiac.ca