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BY COURIER AND EMAIL

May 29, 2017

**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**

Attention: 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  
Fax: 514-864-6381  
[consultation-en-cours@lautorite.qc.ca](mailto:consultation-en-cours@lautorite.qc.ca)

Grace Knakowski  
Secretary  
Ontario Securities Commission  
20 Queen Street West  
22nd floor  
Toronto, Ontario M5H 3S8  
Fax: 416-593-2318  
[comments@osc.gov.on.ca](mailto:comments@osc.gov.on.ca)

Dear Ms. Beaudoin and Ms. Knakowski:

**Re: Proposed National Instrument 91-102: *Prohibition of Binary Options and Related Proposed Companion Policy***

The North American Derivatives Exchange, Inc. ("Nadex") is pleased to provide this comment letter to the Participating Jurisdictions with respect to their Proposed National Instrument 91-102 *Prohibition of Binary Options* ("Instrument") and Proposed Companion Policy 91-102 *Prohibition of Binary Options* ("CP") (collectively, the "Proposed Instrument").

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Nadex is registered with the United States Commodity Futures Trading Commission (“CFTC”) both as a Designated Contract Market (“DCM”) and a Derivatives Clearing Organization (“DCO”). Nadex is one of several U.S. exchanges that list binary options for trading by retail traders. Nadex offers binary options on the widest variety of asset classes of all these exchanges: FX rates, stock index futures, commodities, agricultural futures and economic events. Other US exchanges listing binary options for retail traders include NYSE MKT (single-stock “Binary Return Derivatives”), CBOE (binary options on the S&P 500 Cash Index and the VIX Index) and Cantor Exchange (binary options on FX rates, spot gold and silver and various weather events). Nadex and Cantor Exchange are CFTC-regulated, while NYSE MKT and CBOE are regulated by the United States Securities Exchange Commission. These exchange listed binary options have durations ranging from weekly expirations to daily and intraday expirations. As discussed in more detail below, however, the binary options that Nadex and these other US exchanges list are markedly different than the types of “binary options” that Nadex believes are the driving force behind the Proposed Instrument.

As a regulated market, Nadex wholeheartedly supports the Participating Jurisdictions’ stated purpose in putting forward the Proposed Instrument “to help protect would-be investors from binary options fraud”. However, we believe the Proposed Instrument goes too far in focusing on a particular product as opposed to the bad actors in the space and in broadly defining the product to include the types of perfectly legitimate financial instruments traded on Nadex and other US exchanges. Moreover, the proposal fails to differentiate between the simple up/down contracts marketed predominantly by entirely unregulated firms and labelled as “binary options” (“**fifty/fifties**”), and the genuine volatility-driven binary options that have been offered for many years by regulated firms dealing over the counter in Europe and Japan, or in the United States on Exchanges (“**volatility binaries**”). We understand that the vast majority, if not all, of consumer complaints generated in connection with the marketing and sale of “binary options” concern the fifty/fifties, not the marketing, sale and trading of volatility binaries.

## BENEFITS OF BINARY OPTIONS

With regard to investment needs, volatility binaries allow retail clients to access market risk simply, cheaply and conveniently. This risk may be purchased to offset an existing risk on a wider investment portfolio or economic exposure (i.e. to hedge) or it may be purchased to establish a standalone speculative position.

We do not believe that the discrete nature of binary contract pay-outs, and the fact that these pay-outs do not match perfectly against the continuous returns generated by an investment portfolio, mean they cannot have a role in hedging such investment portfolios. Most hedges are not perfect and there is utility in establishing a partial hedge; the mismatch in pay-outs between a binary pay-out and the loss on an investment portfolio will be compensated for, in the opinion of many investors, by the fact that the loss on a binary hedge (in the event of good performance in their underlying investment portfolio) is also capped.

Volatility binaries (but not fifty/fifties) are the only instrument that could be available to retail clients who want to hedge or speculate on market volatility in a controlled, limited risk manner. No other product commonly available to retail clients can deliver both a bullish and bearish exposure to volatility with a strict cap on risk in either case.

Volatility binaries (but not fifty/fifties) are also the only instrument that could be available to retail clients who want to hedge against, or speculate on, very short term market volatility, for instance of the type created by the release of specific major economic figures. The short tenors available on these instruments allows retail clients a clean exposure to the volatility potentially created by the scheduled release of economic news. Conventional “vanilla” call and put options typically have tenors stretching over days, weeks or months, creating a blended exposure to a broad range of volatility-based risks, not all of which may be of concern or interest to a particular retail client.

Finally, we believe volatility binaries are intuitively well understood, and are traded with great satisfaction, by retail traders. The price of a volatility binary represents the percentage likelihood of a particular market event occurring; for example, the market is indicating that a binary option trading at a best bid of 60 and a best offer of 64 has a 62% (the midpoint of the best bid-ask) likelihood of finishing in the money. This is a proposition that retail traders understand well and on which they are able to form their own independent view.<sup>1</sup>

#### BENEFITS OF NADEX’S BUSINESS MODEL

In addition to the inherent benefits of binary options discussed above, we believe Nadex’s business model offers further benefits to retail traders in the binary options space. As an exchange and clearinghouse, Nadex can offer retail traders all the traditional benefits of formal, regulated markets, including security of funds held by a regulated clearinghouse, rules that govern the fair operation of the market, oversight by a federal regulator, transparent central limit order books, liquidity to enter and exit a position, etc. At the same time, we offer retail traders products designed them, not for large institutions. So, an individual trader on Nadex can trade \$100 contracts – much smaller size than the futures contracts and options typically offered on exchanges – and Nadex’s contracts have absolutely capped risk (and potential reward). All contracts traded on Nadex are fully collateralized with the maximum risk funded up front. As a result, the trader knows his or her full risk at the time they place a trade and even if the underlying market moves strongly against them, they may lose that initial investment but they will never receive a margin call for additional funds to cover losses on that position in excess of their initial investment. In short, Nadex provides a market that offers products designed for retail traders, listed on a regulated exchange.

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<sup>1</sup> Unlike the straightforward volatility binaries, fifty/fifties are typically priced as a wagered amount that pays out some percentage of that wagered amount, e.g., 85%, if the contract finishes in the money, and may pay out a small “consolation amount”, e.g., 10%, in the event the contract finishes out of the money. This pricing model tends to obscure the cost of the fifty/fifties to the trader.

SPECIFIC QUESTIONS:

**1. Does the proposed definition of “binary option” capture contracts or instruments that should not be captured? If so, please specify the types of contracts or instruments that should not be captured and on what basis they would be captured.**

We believe the Participating Jurisdictions should apply two distinct regulatory approaches to what are, in effect, two distinct products:

1. Fifty/Fifties of the type typically marketed to Canadian consumers by incoming online platforms that are lightly regulated, or entirely unregulated; and,
2. Conventional, volatility-based binary options of the type offered to retail traders by Nadex and other US exchanges and by some regulated OTC firms in Europe, Japan and elsewhere.

We think the fifty/fifty binaries have commonly become identified with the term “binary option” but these should best be considered not as an option but as a financial instrument with the economic characteristics of a fixed odds bet. In this regard, we agree that these fifty/fifties have been widely mis-sold to unsophisticated consumers throughout Canada and elsewhere by unregulated firms with very significant negative consumer outcomes as a result. We support any steps the Participating Jurisdictions make in addressing this unsatisfactory situation. Indeed, we think that the scale of the mis-selling is so great it may be appropriate to refrain from permitting regulated firms in Canada from offering the fifty/fifties contract type; i.e., continue the current ban on such contracts in Canada.

We believe, however, that genuine binary options – volatility binaries – have not been mis-sold, are not particularly susceptible to mis-selling and meet a clear investment need for clients who want to hedge, or speculate on, market volatility in a controlled, limited risk manner. They are widely available to retail audiences in other well-regulated markets, such as the US and Japan, and are sufficiently different to the fifty/fifties that a separate regulatory approach is appropriate. That is, the offering of volatility binaries, like vanilla put and call options or other legitimate financial instruments, should be permitted as long as the offeror is appropriately regulated and applicable requirements (client onboarding, risk disclosure, transparency, etc.) are otherwise met.

**2. The Proposed Instrument applies to binary options where the time period specified in the binary option for determining whether the predetermined condition or conditions are met is less than 30 days from the date the binary option is entered into. Is this time period appropriate? Please specify why or why not.**

We do not believe that short durations in and of themselves prevent investors from making informed decisions, or necessarily transform a trading product into something inappropriate. Indeed, all contracts that are available for trading on an exchange have a fixed duration and, no matter its initial term, even a longer term contract will eventually become a one-



day, then a one-hour, then a 1-minute contract as it nears expiration. We believe a 30-day limit is arbitrary. Moreover, it appears that such a limitation may preclude a trader from closing out a position through an offsetting trade with less than 30 days to expiration, thereby limiting the trader's ability to take profits or limit losses.

**3. Staff considered a variety of options that would prevent circumvention of the binary options trading ban. These included provisions that would capture indirect trading by an individual through a company, trust or other entity. As currently drafted, the Proposed Instrument includes an anti-avoidance provision that would ban trading binary options with a person or company that is created, or primarily used, to trade binary options. We believe this approach captures our intent to prohibit attempted work-arounds of the binary options trading ban without increasing the complexity of the rule. Is the proposed provision unambiguous and clear, or should the scope of this provision be modified, for example, to more specifically extend to any person, company or other entity wholly-owned or controlled by an individual?**

As discussed below, Nadex does not believe efforts to designate a particular product as “illegal” or to carve out trading by certain types of market participants (entity v. individual) ultimately will be successful in achieving the Participating Jurisdictions’ objectives. To the contrary, only actions that attack the parties that are acting inappropriately – the unregistered purveyors of on-line binary options – and that limit demand for the illegal product – for example, allowing registered firms and exchanges to offer legitimate volatility binaries as a quality alternative to the unregulated fifty/fifties – will ultimately reduce the amount of fraud currently occurring in the area.

**4. Do you believe the Proposed Instrument will accomplish the intended purpose of proposing it, as set out in this Notice?**

As the Participating Jurisdictions note, the “binary options” that currently are being marketed in Canada already are illegal offerings. We do not believe that the Proposed Instrument will cause those currently illegally offering those products to stop. The better approach, we believe, is to allow regulated firms and/or exchanges to offer volatility binaries as an alternative to the fifty/fifties being marketed in Canada by unregulated firms. This will provide a quality, legal alternative to meet a clear investor interest. At the same time, we believe efforts to attack the bad actors rather than the financial instrument will more effectively protect the Canadian public. For example, Visa and MasterCard recently have taken steps – presumably with the encouragement of the Participating Jurisdictions – to limit the availability of funding to unregistered purveyors of binary options.<sup>2</sup> The Participating Jurisdictions could also work with Google, Yahoo and

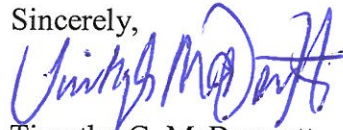
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<sup>2</sup> See *Visa Tightens Screws on Binary Options, Targeting US and Canada* (Sept. 26, 2016), <http://www.financemagnates.com/binary-options/regulation/exclusive-visa-tightens-screws-on-binary-options-targeting-us-and-canada/>, and *MasterCard Determined to Cut Binary Options Deposits from Canada* (Nov. 21, 2016), <http://www.financemagnates.com/binary->

other search engine providers to limit on-line advertising of illegal services to Canadian consumers. We believe such efforts, in concert with enforcement actions taken by the Participating Jurisdictions against the unregulated purveyors of fifty/fifties, will be much more effective in protecting consumers than attempting to ban a financial product.

Thank you for considering our comments. Please contact the undersigned at +1-312-884-0171 or [tim.mcdermott@nadex.com](mailto:tim.mcdermott@nadex.com) if you have any questions about our comments or you would like to meet with us to discuss them further.

Sincerely,



Timothy G. McDermott

Chief Executive Officer

North American Derivatives Exchange, Inc.

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[options/regulation/exclusive-mastercard-determined-to-cut-binary-options-deposits-from-canada/](#).

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