IG

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Retail Complex Products and Investor Protection
Market Supervision
Australian Securities and Investments Commission

By email: Market.Supervision.OTC@asic.gov.au

21 June 2022

Dear Retail Complex Products and Investor Protection,

Response to Consultation Paper 362 *Extension of the binary options product intervention order*

IG Australia and IG Group

By way of brief background, IG Australia Pty Ltd (IG) deals in securities and over-the-counter (OTC) contracts for difference (CFDs) on a broad array of financial instruments, to a retail and wholesale client base.

In Australia, IG is regulated by the Australian Securities and Investments Commission (ASIC) and is a wholly owned subsidiary of an ultimate parent company, IG Group Holdings plc (IG Group), which is a market leader in on-line trading. IG Group has a primary listing on the London Stock Exchange where it is an established member of the FTSE 250. Around the world, IG Group companies are regulated by:

- UK's Financial Conduct Authority;
- Monetary Authority of Singapore;
- US Commodity Futures Trading Commission;
- US National Futures Association;
- US Financial Industry Regulator Authority, Inc.;
- Swiss Financial Market Supervisory Authority;
- Japanese Financial Services Agency;
- Japanese Ministry of Finance;
- New Zealand's Financial Markets Authority;
- Germany's BaFin;
- Dubai Financial Services Authority;
- South African Financial Sector Conduct Authority; and
- Bermuda Monetary Authority

To meet the high expectations of our global regulators, promote a strong culture and mitigate the risk of poor conduct, we have a developed framework which focuses on our clients. We strive to ensure our products and services result in good outcomes for both our clients and the financial markets. We firmly believe and support proportionate regulation that delivers good client outcomes as we feel this leads to a better, long-term sustainable industry. To meet these regulatory requirements, we ensure that we have: (i) a robust governance structure, (ii) products that are designed to meet the needs of IG's target market, (iii) marketing that is appropriately targeted and (iv) dealing practices that deliver best execution.

We are supportive of ASIC's work on protecting Australian retail consumers from practices within the financial services industry that result in consumer detriment. We firmly believe in robust and proportionate regulatory oversight of financial products and services in Australia, and we fully support initiatives that are designed to strengthen protections for retail consumers.

Proposed extension of the Binary Options Order

D1Q1 Do you agree with our proposal to extend the Binary Options Order until it is revoked or sunsets? If not, why not? Should the Binary Options Order instead be extended for a shorter period?

Given the surprising size of the binary options industry in Australia prior to the implementation of the Binary Options Order (the 'Order') combined with the history of aggressive and misleading marketing practices that targeted less sophisticated clients, we agree with ASIC's proposal to extend the Order until it is revoked or sunsets.

However, as explained in our response to CP 322 *Product intervention: OTC binary options and CFDs* (CP 322), we do not agree with ASIC's view that binaries provide no economic utility. We believe binary options are a niche, but useful financial product that have been sold, and more often mis-sold, to too wide an audience. We agree with ASIC that the scale of this problem warranted intervention. Notwithstanding this, we still feel there are some points within the consultation paper that should be addressed. We reiterate that the definition of a binary option, which is broad, appears wider than its perception of a binary option when analysing client detriment. The design and merits of the most common variants of binary options were outlined in our response to CP322 and are repeated below.

Fifty/Fifty Binaries

While there is nothing inherently wrong with a binary option as a product in our view, the features of this kind of binary option - "Fifty/fifties" - appeal to a particular kind of firm that aggressively targets an unsophisticated audience, often with misleading or false claims on profitability.

These contracts are extremely simple: the strike price "floats", being set when a client trades, at the level of the underlying market at that precise moment. Because of this they are always 50/50 propositions – the trader is predicting only the direction of the market over the tenor of the contract. It is the simplicity - not the complexity - of these products that appealed to unscrupulous brokers. This makes the contracts easy to price, therefore cheap to offer, and (as ASIC noted) their resemblance to traditional gambling is used to appeal to an unsophisticated audience.

Within the definition of a binary option in CP322, ASIC captures all types of binaries, but refers almost exclusively to fifty/fifties when illustrating client detriment from the product. In truth, for fifty/fifties, the inability to choose a strike price or close the position, the absence of volatility in determining pricing, and the price defined as a return on a fixed stake mean it is difficult to describe this product as an "option" in the traditional sense. We would speculate that well over 90% of binary industry revenue, and nearly all problems from dishonest operators involve these products.

Volatility Binaries

Prior to the implementation of the Order IG offered another kind of binary option which we refer to as a "volatility binary option". Volatility binary options made up most of our binary options business before the Order became effective.

Volatility binary options were not 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 (two historically conservative jurisdictions with respect to retail trading), and are available on various exchanges, such as the CBOE and NYSE. These products are different to the products described previously to the point that a separate regulatory approach would not be unreasonable.

These contracts differ from fifty/fifties in that:

- The strike price is fixed and known in advance;
- They are priced in the conventional way of all financial instruments: as a 2-way, bid/ask spread; and
- The price evolves and can be continuously traded over the life of the contract, before settling at 100 (if the outcome described in the binary's name occurs) or 0 (if the outcome does not occur).

Clients trading these binaries were almost always trading on whether a market moves a set distance in a certain timeframe – they were trading on future market volatility. The sophistication required to price these contracts, along with their limited appeal to inexpert clients means they were rarely offered by dishonest firms. That said, the contracts are still simple to comprehend – the price represents a percentage chance of an event occurring. A client who places a trade on this style of option is taking the view that market volatility in the future will be higher or lower than the market maker's perception. For this reason, volatility binaries have historically been one of the markets our global client base outperforms on – a client trading these products only needs a more informed view than the market maker, rather than the market. Of course, as with all speculative trading, clients tend to roughly lose transaction costs in aggregate.

In summary, in the absence of providers in the industry that engage in poor conduct, we view binary options as a legitimate trading tool for a suitable audience of traders. While we are disappointed an alternate solution was not found to the mis-selling problem that plagued the industry, we agree with ASIC that the extension of the Binary Options Order is warranted in this case in the interest of consumers.

D1Q2 In your view has the Binary Options Order been effective in reducing the risk of significant detriment to retail clients? Please provide evidence and data in support of your view where possible.

As retail clients were unable to access binary options from the date the Order came into effect, retail clients have not incurred losses (and equally, have not made profits) during this period.

D1Q3 For binary options issuers, if the Binary Options Order is not extended would you change your business model and what benefits and costs would you incur?

It is unlikely IG would change its business model if the Order is not extended.

D1Q4 For binary options issuers and distributors, what impact has the Binary Options Order had on your financial services business?

Binary options were not a material part of IG's business and therefore there the Order has had minimal impact on our business.

D1Q5 For retail clients of binary options issuers, has the Binary Options Order changed your trading? If so, please explain how. For example:

(a) have you substituted other investment products for binary options?
(b) did you move your binary options trading to an overseas binary options issuer that permitted retail trading
(c) did you apply to be classified as a wholesale investor to continue trading binary options with an AFS-licensed binary options issuer?

(d) do you agree there is a high likelihood of cumulative financial losses from trading binary options over time due to the product's characteristics?
(e) how have your profits or losses from trading binary options affected you?

This question is not applicable to IG.

D1Q6 What effects (if any) do you consider the Binary Options Order has had on competition in the financial system? What effects are likely if the Binary Options Order is extended

We do not believe the Order has had a material effect on competition within the financial system.

Please contact me on [redacted] if you would like to discuss any of the matters above.

Yours sincerely,

[redacted]

Head of APAC & Africa