

FMA FOCUS

BINARY OPTIONS, CONTRACTS FOR DIFFERENCE

BINARY OPTIONS, CONTRACTS FOR DIFFERENCE (CFDs) AND OTHER HIGH RISK PRODUCTS

The Austrian Financial Market Authority (FMA) particularly urges exercising utmost caution when dealing with binary options and contracts for difference (CFDs).

These products are high risk, complex and speculative, and entail a considerable risk of loss. They are therefore not suited to sustainable investment purposes.

High risk financial products are being offered to private investors on an ever increasing basis, in particular in the form of "binary options" and "contracts for difference" (CFDs). The apparent trading of foreign currencies is increasingly being offered as "FX Trading" or "Rolling Spot Forex Contracts". Such products are advertised using a range of aggressive sales practices, and are frequently sold to private investors without any pre-sales investment advice.

Promises are often made of there being opportunities for high returns with a low risk attached to the investment. In this case the basic principle applies: if something sounds too good to be true, probably is not true. High returns are typically associated with an increased risk. If you are being sold "hot tips" or "miracle products", promising high returns without any risk, utmost caution is required. Consumers are frequently contacted in an unsolicited manner, often over the telephone, and are offered a financial investment. Such "cold calling" is prohibited under law in Austria, and it therefore makes sense to hang up straightaway if you receive such calls.

BINARY OPTIONS

Binary (digital) options are high-risk forward transactions, functioning in a similar manner to placing a bet. Investors speculate on whether a price falls or rises. The investor bets whether the price will be lower or higher than a certain threshold value, such as the price at the time of the conclusion of the trade, at a determined point in the future. In the event that the case predicted by the investor occurs, then the investor wins and receives a predetermined amount, which as a rule is always less than twice the amount of the capital invested. In the event that the case predicted by the investor does not occur, then the option becomes worthless, and the investor loses their entire invested capital. A total loss occurs.

BINARY OPTIONS - FREQUENT RISKS AND DISADVANTAGES OF POPULAR BUSINESS MODELS

The risks and disadvantages that emerge in popular business models for binary options, include that the binary options are non-exchange-listed products that are frequently created by the provider itself. Providers frequently have conflicts of interest arising as a result of their own profit-making intentions. Binary options may therefore be designed in a detrimental way for investors. A 100% loss, i.e. a total loss, is possible from the transaction, but at the same time, it is however possible to make a profit that is substantially lower than 100%.

Furthermore, in the event of there being an unfavourable development in the underlying assets, as a rule there is not possibility for the investor to opt-out at earlier stage in order to limit the extent of their loss.

Internet security-based risks are also generally to the detriment of the investor, since systems for binary options are frequently very unclear, and susceptible to fraud.

CONTRACTS FOR DIFFERENCE (CFDs)

In a contract for difference (CFD) the investor speculates on the change in value of the underlying assets, e.g. a share, a commodity, a currency or an index. However, the underlying asset itself is not purchased, instead there is just a bet placed in relation to the change in value. The purchaser is therefore only required to deposit a small proportion of the value of the underlying asset as security with the provider. In the event that the value develops positively, the investor receives the difference. In the event of the value decreasing the investor is required to compensate for the difference. Due to the low stake, the leverage effect allows large wins to be achieved, or in a negative scenario large losses to be incurred. **The difference to be compensated by the investor in this case may multiple tiems the amount of the invested capital, and may lead to obligations to make supplementary payments.**

Contracts for difference should therefore not be used for speculative purposes, but are only suitable for professional and very experienced investors for purposes such as the hedging of risk of securities portfolios.

FX-TRADING OR ROLLING SPOT FOREX CONTRACTS

"Forex" is an abbreviation for the foreign exchange market and is a decentralised international market for buying and selling currency, and is typically used by banks. Providers have developed various different financial products to make the market accessible for private investors with a low amount of capital. Contracts for difference also exist for such products, in which the investor is able to bet on the exchange rate of currency pairs (e.g. EUR/USD). Other differently designed products, such as forwards, futures or options, which are settled in cash, also exist, although are comparatively seldom. As a rule the offerings are designed in such a way that private investors never actually purchase the foreign currency, but are only able to speculate on the development of the exchange rate by placing a deposit by way of security ("margin").

CONTINUE TO ASK QUESTIONS UNTIL YOU FULLY UNDERSTAND THE PRODUCT AND ASSOCIATED RISKS

Binary options and CRDs are generally advertised via online platforms or advertisements and sold without any pre-sales advice. Private investors generally do not however have the required knowledge and experience for trading in financial derivatives.

It has become apparent in the past that investors have frequently not been fully aware of the risks of such products, and have also sustained considerable losses. Advertising for such products frequently highlights the potential profits, without adequately advising about the risk of a total loss. Certain advertising messages also suggest that there is little to no risk involved in such products. This is not the case. Such products contain high risks, are complex, speculative and are not suitable for sustainable investment purposes. Such products are not standardised and the characteristics of products may vary from one provider to the next.

The FMA therefore explicitly advises against committing to investments in such products without seeking adequate advice and explanation about the risks entailed, and explicitly advises of the significant risk of losses entailed in such highly speculative investments. The principle applies that, you should continue to ask questions until you fully understand the product and the associated risks!

PROVIDERS ARE FREQUENTLY NOT SUBJECT TO ANY KIND OF SUPERVISION

Binary options - particularly those based on underlying assets like securities, currencies, interest rates, financial indexes or commodities settled in cash - as well as contracts for difference and other foreign-currency based financial derivatives (keyword: "Forex") are classified as financial instruments pursuant to Article 1 no. 6 point d) or i) of the Austrian Securities Supervision Act 2007 (WAG 2007; Wertpapieraufsichtsgesetz 2007) and are therefore only permitted to be offered by licenced investment service providers (= credit institutions and investment firms).

The FMA has determined that binary options and contracts for difference (CFDs) are frequently offered by undertakings that are not authorised to provide investment services in Austria. Consequently the risk of their misuse for criminal purposes, particularly with regard to fraud or breach of trust is therefore especially high, with any form of legal enforcement or enforcement of claims for damages sustained being particularly difficult or even impossible.

Providers that are authorised in an EU Member State and which are supervised, may also provide their offerings to Austrian customers via an "EU passport" under the freedom to provide services. Such undertakings are principally subjected to the oversight and supervision by the competent authority in their home state, rather than that of the FMA. The undertakings are in any case obliged to comply with the conduct rules under MiFID (Markets in Financial Instruments Directive). Since mid-2015, the European Securities and Markets Authority (ESMA) has worked intensively on the further development of investor protection provisions in relation to binary options, CFDs and other high risk financial products within a dedicated working group. The FMA also has an active role on a European level in increasing the protection for private investors.

The FMA therefore urgently advises all investors, prior to the conclusion of securities transactions, to inform themselves fully about the opportunities and risks associated with such transactions as well as to establish whether a provider is in fact authorised for such transactions, and not to conduct any transactions, if the provider does not hold the requisite licence or in the event that there is no clearly understandable and transparent information available.

FURTHER INFORMATION

Prior to committing to any investment, please consult our tips on investing, which can be found on our website at the following address:

<https://www.fma.gv.at/en/the-basics-the-financial-market/the-basics-investing/>

The FMA warns consumers to exercise the utmost caution in particular with regard to trading in binary options and contracts for difference (CFDs) and refers to the following warning and press release issued by the European Securities and Markets Authority (ESMA):

<https://www.esma.europa.eu/press-news/esma-news/esma-issues-warning-sale-speculative-products-retail-investors>

https://www.esma.europa.eu/sites/default/files/library/2016-1166_warning_on_cfds_binary_options_and_other_speculative_products_0.pdf