



SEC

OFFICE of INVESTOR
EDUCATION and ADVOCACY

INVESTOR ALERT

Binary Options and Fraud

The SEC's Office of Investor Education and Advocacy and the Commodity Futures Trading Commission's Office of Consumer Outreach (CFTC) are issuing this Investor Alert to warn investors about fraudulent promotion schemes involving binary options and binary options trading platforms. These schemes allegedly involve, among other things, the refusal to credit customer accounts or reimburse funds to customers, identity theft, and manipulation of software to generate losing trades.

Binary Options

Binary options differ from more conventional options in significant ways. A binary option is a type of options contract in which the payout will depend entirely on the outcome of a yes/no proposition.

The yes/no proposition typically relates to whether the price of a particular asset that underlies the binary option will rise above or fall below a specified amount. For example, the yes/no proposition connected to the binary option might be something as straightforward as whether the stock price of XYZ company will be above \$9.36 per share at 2:30 pm on a particular day, or whether the price of silver will be above \$33.40 per ounce at 11:17 am on a particular day. Once the option holder acquires a binary option, there is no further decision for the holder to make as to whether or not to exercise the binary option because binary options exercise automatically. Unlike other types of options, a binary option does not give the holder the right to

purchase or sell the underlying asset. When the binary option expires, the option holder will receive either a pre-determined amount of cash or nothing at all. Given the all-or-nothing payout structure, binary options are sometimes referred to as “all-or-nothing options” or “fixed-return options.”

Binary Options Trading Platforms

Some binary options are listed on registered exchanges or traded on a designated contract market that are subject to oversight by United States regulators such as the SEC or CFTC, respectively, but this is only a portion of the binary options market. Much of the binary options market operates through Internet-based trading platforms that are not necessarily complying with applicable U.S. regulatory requirements. The number of Internet-based trading platforms that offer the opportunity to purchase and trade binary options has surged in recent years. The increase in the number of these platforms has resulted in an increase in the number of complaints about fraudulent promotion schemes involving binary options trading platforms.

Much of the binary options market operates through Internet-based trading platforms that are not necessarily complying with applicable U.S. regulatory requirements and may be engaging in illegal activity.

Typically, a binary options Internet-based trading platform will ask a customer to deposit a sum of money to buy a binary option call or put contract. For example, a customer may be asked to pay \$50 for a binary option contract that promises a 50% return if the stock price of XYZ company is above \$5 per share when the option expires.

If the outcome of the yes/no proposition (in this case, that the share price of XYZ company will be above \$5 per share at the specified time) is satisfied and the customer is entitled to receive the promised return, the binary option is said to expire “*in the money*.” If, however, the outcome of the yes/no proposition is not satisfied, the binary option is said to expire “*out of the money*,” and the customer may lose the entire deposited sum.

There are variations of binary option contracts in which a binary option that expires out of the money may entitle the customer to receive a refund of some small portion of the deposit—for example, 5%—but that is not typically the case.

In fact, some binary options Internet-based trading platforms may overstate the average return on investment by advertising a higher average return on investment than a customer should expect, given the payout structure. For instance, in the example above, assuming a 50/50 chance of winning, the payout structure has been designed in such a way that the expected return on investment is actually *negative*, resulting in a *net loss* to the customer. This is because the consequence if the option expires out of the money (approximately a 100% loss) significantly outweighs the payout if the option expires in the money (approximately a 50% gain). In other words, in the example above, an investor could expect, on average, to lose money.

Investor Complaints Relating to Fraudulent Binary Options Trading Platforms

The SEC and CFTC have received numerous complaints of fraud associated with websites that offer an opportunity to buy or trade binary options through Internet-based trading platforms. The complaints fall into at least three categories: refusal to credit customer accounts or reimburse funds to customers; identity theft; and manipulation of software to generate losing trades.

The first category of alleged fraud involves the refusal of certain Internet-based binary options trading platforms to credit customer accounts or reimburse funds after accepting customer money. These complaints typically involve customers who have deposited money into their binary options trading account and who are then encouraged by “brokers” over the telephone to deposit additional funds into the customer account. When customers later attempt to withdraw their original deposit or the return they have been promised, the trading platforms allegedly cancel customers’ withdrawal requests, refuse to credit their accounts, or ignore their telephone calls and emails.

The second category of alleged fraud involves identity theft. For example, some complaints allege that certain Internet-based binary options trading platforms may be collecting customer information such as credit card and driver’s license data for unspecified uses. If a binary options Internet-based trading platform requests photocopies of your credit card, driver’s license, or other personal data, do not provide the information.

The third category of alleged fraud involves the manipulation of the binary options trading software to generate losing trades. These complaints allege that the Internet-based binary options trading platforms

manipulate the trading software to distort binary options prices and payouts. For example, when a customer's trade is "winning," the countdown to expiration is extended arbitrarily until the trade becomes a loss.

Unregistered Transactions, Operations, Broker-Dealers, or Trading Exchanges; Illegal Options Transactions

In addition to ongoing fraudulent activity, many binary options trading platforms may be operating in violation of other applicable laws and regulations, including certain registration and regulatory requirements of the SEC and CFTC, as described below.

Certain Registration and Regulatory Requirements of the SEC

For example, some binary options may be securities. Under the federal securities laws, a company may not lawfully offer or sell securities unless the offer and sale have been registered with the SEC or an exemption from such registration applies. For example, if the terms of a binary option contract provide for a specified return based on the price of a company's securities, the binary option contract is a security and may not be offered or sold without registration, unless an exemption from registration is available. ***If there is no registration or exemption, then the offer or sale of the binary option to you would be illegal.***

If any of the products offered by binary options trading platforms are security-based swaps, additional requirements will apply.

In addition, some binary options trading platforms may be operating as ***unregistered broker-dealers***. A person who engages in the business of effecting securities transactions for the accounts of others in the U.S.

generally must register with the SEC as a broker-dealer. If a binary options trading platform is offering to buy or sell securities, effecting transactions in securities, and/or receiving transaction-based compensation (such as commissions), it likely should be registered with the SEC. To determine whether a particular trading platform is registered with the SEC as a broker-dealer, visit the [FINRA BrokerCheck](http://www.finra.org/investors/toolscalculators/brokercheck/) website (www.finra.org/investors/toolscalculators/brokercheck/).

Some binary options trading platforms may also be operating as ***unregistered securities exchanges***. This would be the case if they matched orders in securities of multiple buyers and sellers using established non-discretionary methods. However, there are cases where a registered broker-dealer with a trading system or platform may legitimately have no obligation to register as an exchange.

Certain Registration and Regulatory Requirements of the CFTC

It is **illegal** for entities to solicit, accept offers, offer to or enter into commodity options transactions (for example, foreign currencies, metals such as gold and silver, and agricultural products such as wheat or corn) with U.S. citizens, unless those options transactions are conducted on a designated contract market, an exempt board of trade, or a *bona fide* foreign board of trade, or are conducted with U.S. customers who have a net worth that exceeds \$5 million.

To date, only one entity that offers binary options has been granted status as a designated contract market—the North American Derivatives Exchange, Inc. All other entities that are offering binary options that are commodity options transactions are doing so illegally.

Further, entities that solicit or accept orders for commodity options transactions and accept, among other things, money to margin, guarantee, or secure the commodity options transactions must register as a **Futures Commission Merchant**. Entities that act as the counterparty (that is, they take the other side of the transaction from the customer as opposed to matching orders) for foreign currency options transactions for customers with a net worth of less than \$5 million must register as a **Retail Foreign Exchange Dealer**.

Because of their lack of compliance with applicable laws, if you purchase binary options offered by persons or entities that are not registered with or subject to the oversight of a U.S. regulator, *you may not have the full benefit of the safeguards of the federal securities and commodities laws that have been put in place to protect investors, as some safeguards and remedies are available only in the context of registered offerings*. In addition, individual investors may not be able to pursue, on their own, some remedies that are available for unregistered offerings.

Final Words

- Remember—much of the binary options market operates through Internet-based trading platforms that are not necessarily complying with applicable U.S. regulatory requirements and may be engaging in illegal activity.
- Do not invest in something that you do not understand. If you cannot explain the investment opportunity in a few words and in an understandable way, you may need to reconsider the potential investment.
- Before investing in binary options, you should take the following precautions:
 - Check to see if the binary options trading platform has registered the offer and sale of the product with the SEC. Registration provides investors access to key information about the terms of the product being offered. You can use EDGAR (www.sec.gov/edgar/searchedgar/webusers.htm) to determine whether an issuer has registered the offer and sale of a particular product with the SEC.
 - Check to see if the binary options trading platform itself is registered as an exchange. To determine whether the platform is registered as an exchange, you can check the SEC website regarding [Exchanges](http://www.sec.gov/divisions/marketreg/mrexchanges.shtml) at www.sec.gov/divisions/marketreg/mrexchanges.shtml.
 - Check to see if the binary options trading platform is a designated contract market. To determine whether an entity is a designated contract market, you can check the CFTC website at <http://sirt.cftc.gov/SIRT/SIRT.aspx?Topic=TradingOrganizations&implicit=true&type=DCM&CustomColumnDisplay=TTTTTTTT>.
- Finally, before investing, check out the registration status and background of any firm or financial professional you are considering dealing with at [FINRA BrokerCheck](http://www.finra.org/investors/tools/calculators/brokercheck/) (www.finra.org/investors/tools/calculators/brokercheck/) and [BASIC Search](http://www.nfa.futures.org/basicnet/) (www.nfa.futures.org/basicnet/), the National Futures Association Background Affiliation Status Information Center. If you cannot verify that they are registered, don't trade with them, don't give them any money, and don't share your personal information with them.

Related Information

[EDGAR](http://www.sec.gov/edgar/searchedgar/webusers.htm) (*www.sec.gov/edgar/searchedgar/webusers.htm*)

[FINRA BrokerCheck](http://www.finra.org/investors/toolscalculators/brokercheck/) (*www.finra.org/investors/toolscalculators/brokercheck/*)

[BASIC Search](http://www.nfa.futures.org/basicnet) (*www.nfa.futures.org/basicnet*)

[SEC Publication: Ask Questions](http://www.sec.gov/investor/pubs/sec-questions-investors-should-ask.pdf) (*www.sec.gov/investor/pubs/sec-questions-investors-should-ask.pdf*)

[SEC Investor Alert: Social Media and Investing—Avoiding Fraud](http://www.sec.gov/investor/alerts/socialmediaandfraud.pdf) (*www.sec.gov/investor/alerts/socialmediaandfraud.pdf*)

[CFTC Consumer Protection](http://www.CFTC.gov/consumer_protection) (*www.CFTC.gov/consumer_protection*)

[International Organization of Securities Commissions \(IOSCO\)](http://www.iosco.org/lists/index.cfm?section=general) (*www.iosco.org/lists/index.cfm?section=general*)

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