

Forcing the regulator's hand on binary options in the Netherlands

A recent Dutch Administrative Appeals Court ruling has resulted in the confirmation that the Dutch financial watchdog shall regulate games of chance involving binary options in the Netherlands. Bas Jongmans and Hester Bais - the Dutch lawyers acting for binary options provider Optionclub in the proceedings - discuss the complex situation in regards to binary options in the Netherlands and the need for the financial watchdog to begin actively regulating the market and taking action against illegal operators.

On 4 October 2016, in a final ruling, the Dutch Administrative Appeals Court ('CBB') confirmed the services of Dutch binary options provider 'Optionclub' under the Dutch Act on Financial Supervision ('AFS' or 'Wft'), through which the European Directive on Markets in Financial Instruments ('MiFID') is implemented¹. The final confirmation of the licence marks an important step in the development of the regulation of binary options as financial instruments within the Netherlands, since with this issuance, the Dutch financial watchdog AFM has confirmed that binary options shall be regulated by AFM in the Netherlands and as a result, licence holders shall be allowed to enter the European market, using a so-called 'European Passport.'

In light of earlier developments, it was doubtful whether AFM would actually issue a licence to Optionclub at all. Optionclub applied for the licence in 2012. Applications for investment service licences should in principle take no longer than 13 weeks. The application slowly morphed into a fight between Optionclub's lawyers Bas Jongmans and Hester Bais - the writers of this article - and the AFM.

So what are binary options?

The word 'binary' is derived from the possible outcomes. There are only two: 1 or 0. The buyer of a binary option determines whether the price of an index, stock, currency pair or commodity at the end of the option will be higher or lower than at closing. Depending on the outcome, the buyer earns a premium,

alternatively, the buyer loses the original purchase price. With binary options no actual underlying products are traded, their value is 'derived' from something else. That is why binary options belong to the family of derivative financial products or in short: 'derivatives.' A derivative may entitle the buyer to the value of the underlying securities, but they may also be settled in cash.

AFM took as its primary position that the offering of binary options is illegal since binary options should be regarded (next to financial instruments) as illegal games of chance. AFM's arguments, however, proved not to be very convincing. On 16 January 2015, the Rotterdam Administrative Court ruled that AFM should issue a licence to Optionclub within six weeks after its ruling². After months had passed, AFM still refused. AFM then filed a preliminary injunction with the CBB Appeals Court, requesting a suspension of the court order. That backfired. Not only did the CBB deny the watchdog's request, it even granted Optionclub's counterclaim that AFM should immediately issue the licence. CBB felt that Optionclub could no longer be expected to wait for its licence, pending further litigation on the matter³. Again, weeks passed and AFM still refused to issue the licence. Then, Optionclub turned to the civil court and requested another court order, this time in connection with penal fines against AFM, which then resulted in a temporary licence.

On 30 October 2015 the *Optionclub* case led to questions in the Dutch

Parliament⁴. Parliament requested that the Dutch Secretary of Finance and the Under Secretary of Security and Justice to explain how it was possible that these binary options were not deemed games of chance and regulated as such. Furthermore, the Dutch Parliament wanted the European legal framework explained.

It is quite unusual that Governmental bodies act in such a way. One may wonder what caused AFM to defend its position so vigorously, up to the point that it even ignored several court orders?

The truth of the matter is, derivatives have been 'around the block' for quite some time. They have been trading on specific US markets for decades, for example as 'Contracts for Difference' ('CFDs'). If the difference between the value of the derived products between the time of purchase and the sale is settled in cash only, the derivative is called a CFD. Although a binary option is also exclusively settled in cash, the definition of a CFD is wider. Binary options are, as explained, 'binary' because they only have two possible outcomes. CFDs have more potential outcomes, as there are several 'traditional' products with similar characteristics (such as cash settled futures and index options) which have been and are still traded on European regulated markets.

However, it is still not clear why or how potential elements of games of chance would provide the financial watchdog with a legal basis to approve or deny



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certain financial instruments. After all, does trading not always involve a certain element of uncertainty, an element of risk? From a more philosophical point of view, would life be less fun without having some risk from time to time?

In the spring of 2011, Optionclub already shared its intentions with the Dutch financial watchdog to facilitate binary trading under a Dutch licence and asked AFM for its opinion on the matter. It appears that AFM did not know how to respond. It took AFM one and a half years to draft a reply. It responded in the fall of 2012, stating that the offering of binary options should indeed be regulated by AFM under an investment services licence. Since AFM was of the opinion that Optionclub should apply for a licence, it moved forward with its application. Soon after that, it became painfully clear that AFM felt the application to be extremely undesirable. After two years had passed, Optionclub hired a legal team, demanding action, since AFM did not decide on the licence application in a timely manner. Another year passed before AFM rejected the application, stating that, in retrospect, Optionclub should have filed for an online gambling licence with the Dutch Gambling Authority ('Kansspelautoriteit' or 'DGA'). Since the Dutch regime did not provide for online gambling licences (and at the present time this still remains unchanged) it seemed that the AFM felt that the situation would resolve itself quickly.

But then, for AFM, things got even more hairy. On 18 February 2015, the DGA

released its own statement that it felt that it had no business in regulating financial instruments that might have characteristics of games of chance as well⁵. This forced the AFM into the rather awkward position that it should have an opinion on games of chance. And as already mentioned, CBb ruled that AFM indeed had no business in doing so.

After all of this has transpired, one might wonder whether the legal framework regulating financial instruments is 'up to the task'? Is the public protected in a sufficient matter and how, if at all, should the individuals be protected against themselves?

On 1 November 2007, the European Directive MiFID came into force in the Netherlands. Combined with all of its implementing regulations, it is quite extensive. However, there has been much criticism of the very short-term implementation of the MiFID. Understandable criticism, in our opinion, given that the Act which implemented MiFID was presented to the Dutch Parliament on 25 June 2007⁶, giving the Dutch Parliament its summer recess only to 'think things over.' Fast-tracking important legislation seems unwise, since it tends to cause complications that are unforeseen. It is not extremely evident that MiFID should be blamed, on the contrary.

In practice, the Dutch introduction of new types of financial instruments indeed appeared to cause many problems. The Ministry of Justice (the watchdog DGA did not yet exist) considered

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1. <http://uitspraken.rechtspraak.nl/inziendocument?id=ECLI:NL:CBb:2016:273>
2. <http://uitspraken.rechtspraak.nl/inziendocument?id=ECLI:NL:RBROT:2015:174>
3. <https://www.rechtspraak.nl/Organisatie-en-contact/Organisatie/College-van-Beroep-voor-het-bedrijfsleven/Nieuws/Paginas/AFM-moet-vergunning-verlenen-aan-Optieclub.aspx>
4. <https://zoek.officielebekendmakingen.nl/kv-tk-2015Z20311.html>
5. <http://www.kansspelautoriteit.nl/nieuws/alle-nieuwsberichten/2015/februari/richtsnoer/>
6. Dutch Parliamentary records, 11 2006/07, 31 086, nr. 1.
7. gaminglegal.com/commentsonMiFID (Magazine for financial law, 7 and 8 August 2010).
8. <https://fd.nl/beurs/1168059/optieclub-vindt-reclameverbod-binaire-opties-wetgeving-voor-de-buhne>
9. AFM's slogan: 'AFM is committed to fair and transparent financial markets,' www.afm.nl

The Cbb ruling is expected to have profound effects on the industry as a whole, especially at a time when, for example, Cypriot watchdog CySEC seems to have become more strict and stringent.

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certain financial instruments within games of chance, which led to the legal position that these instruments should also be regulated by a gaming licence as well. That position however is inconsistent with the premise of MiFID that implementation into national law should lead to full harmonisation. Or in other words: when it comes to the regulation of financial instruments MiFID is not intended to allow Member States to make up their own mind. What is rather peculiar is that during the negotiations around MiFID the Dutch legislator was given all the opportunities to limit harmonisation and to 'opt out' on certain matters. It now seems that fast tracking MiFID during the Parliamentary recess has had its ramifications, since Parliament did not 'opt out' of anything of relevance. That Parliament did not study the implementation of MiFID a little harder has been unfortunate. The legislator was warned explicitly, in August 2010 to be exact, to provide answers concerning financial instruments that may also have hallmarks of games of chance⁷.

So what needs to happen now?

Although the time for opting out on MiFID has long gone, it is not yet too late for the Dutch Government to take MiFID seriously. Firstly, MiFID provides

ample opportunity to act on illegal providers of financial instruments. AFM does not need new legislation to perform this task in a more effective manner⁸. It is probably not going to become any more effective if AFM is not open to change and furthermore if it does not take supervision of those products more seriously.

AFM may publicly warn, fine and/or even prohibit execution of transactions by parties who have a presence within the Netherlands. AFM may turn to 'colleague' regulators in other Member States and ask for obligatory assistance in acting against illegal operators that are active within the borders of other Member States. If the Member State does not comply, regulators may complain to the European watchdog: the European Securities and Markets Authority ('ESMA'). Instead of 'complaining' at a European level, AFM might consider utilising its broad authority on the matter.

It would be considered a favour to the vulnerable European citizen to be protected from all those illegal operators who tend to molest the public with often aggressive and unsolicited internet commercials in which tens of

thousands of Euros are promised as a result of investing in financial products. It does not need mentioning that all of this is in direct violation of the strict marketing rules as set out in MiFID. AFM, however, seems unaware, or even uninterested. In that lies the real problem: whether AFM really wants to address the problem or not. AFM has been 'appointed' by the Dutch Appeals Court to supervise investment services in relation to all financial instruments. This means that AFM needs to act on new applications, objectively, honestly, transparently and within a reasonable time, like the AFM's slogan asserts⁹. It is also the outcome desired by the DGA. It is therefore AFM and not the DGA which needs to protect not only the public, but also licence holders against illegal operators.

The Cbb ruling is expected to have profound effects on the industry, especially at a time when, for example, Cypriot watchdog CySEC seems to have become more strict and stringent. Thus, it might not be a luxury for AFM to 'brush up' on the extensive possibilities MiFID has to offer. Otherwise, it is only a matter of time before more and more illegal operators 'flock' to the Dutch border.