

April 24, 2013
Financial Futures Association of Japan
Binary Option Working Group

Publication of Final Report by Binary Option Working Group

Over-the-counter binary option transactions with individuals the underlying assets of which are currencies (currency indices) have been attracting investors as a new type of derivatives transactions, and the number of investors and the gross amount of investment are increasing significantly. The Association set up “Binary Option Working Group (WG)” in September 2012 in order to discuss about instruments specifications necessary to encourage continuous sound growth as financial instruments transactions, measures to protect investors and measures to gain credibility of investors on trade prices in respect of over-the-counter binary option transactions with individuals having inherent features such as risk type different from foreign exchange margin transactions which have already become widely popular among investors.

The WG completed the principles of self-regulations in December 2012. Since then, the WG has held further discussions to embody it, and came to the conclusion. We publish the final report “Self-Regulation of Over-The-Counter Binary Option Transactions with Individuals the Underlying Assets of Which Are Currencies (Currency Indices) (Final Report)”, as attached.

The WG expects that the Association will establish self-regulations in accordance with this final report in a timely manner and that a Member of the Association will pursue the implementation of the business system to carry out over-the-counter binary option transactions with individuals.

Contact: Office of Secretariat of Association
03-5280-0881
ffaj@ffaj.or.jp

* This English version is a translation of the original Japanese text. The original Japanese text will prevail should there be any difference in meaning between the English and Japanese versions.

April 24, 2013
Financial Futures Association of Japan
Binary Option Working Group

Self-Regulations for Over-The-Counter Binary Option Transactions with
Individuals Underlying Assets of Which are Currencies (Currency Indices)
(Final Report)

The Working Group has discussed about embodiment of self-regulations for over-the-counter binary option transactions mainly with individual investors the underlying assets of which are currencies (currency indices) which are traded continuously and repeatedly (hereinafter referred to as “over-the-counter binary option transactions with individuals”), based on “Regulatory Principles for Binary Option Transactions with Individuals” completed on December 12, 2012 (Attachment 2: hereinafter referred to as “Regulatory Principles”).

The Working Group came to the conclusion of such discussions recently and reports the result along with the Regulatory Principles.

Overview

Over-the-counter binary option transactions with individuals are transactions based on complex theories and are not yet widely recognized as derivatives transactions among investors compared with foreign exchange margin transactions as of now. Over-the-counter binary option transactions with individuals have different characters from other types of derivatives transactions such as foreign exchange margin transactions in terms of risks in investment profit and loss.

Financial instruments firms should recognize their responsibilities to design the instruments which contribute to the protection of customers and customers’ interests, and therefore need to offer instruments which are designed not to encourage customers’ excessive speculation.

Considering such character of over-the-counter binary option transactions with individuals and financial instruments firms’ responsibilities, the following measures shall be taken.

Principle 1 Matters regarding “providing accurate knowledge”

(1) Explanation of risk and instruments specification before trading

(1) With respect to the Remarks on instruments specification and trading risk, etc. on financial futures transactions (hereinafter referred to as “Remarks”), we have recognized them as necessary for investors to understand fully and made efforts to take required measures. Self-regulations shall be provided for the following matters in order to ensure thorough explanation to customers regarding instruments specification and Remarks, considering the characteristic of over-the-counter binary option transactions with individuals.

- A Member shall publish the summary of transactions stated in the Explanatory Guide and the explanation (interpretation) to understand the summary thereof to bring them to the attention of the public through its website, etc.
- A Member shall describe the Remarks clearly in the Acknowledgment documents and the concrete explanation in the Explanatory Guide.
- A Member shall clarify the concrete place of the explanation in the Explanatory Guide in the Remarks in the Acknowledgment documents.
- A Member shall publish the Remarks and the concrete explanation thereof to bring them to the attention of the public through its website, etc.
- A Member shall state the following matters as the Remarks, excluding matters inapplicable to transactions offered by the Member.
 - ① The transaction has a due date;
 - ② Investment principal will be zero if the projection went wrong as at the judgment time for long positions held by a customer.
 - ③ The payout amount shall be paid if the projection went wrong as at the judgment time for short positions held by a customer and such payout amount will exceed the amount received and result in investment loss.
 - ④ The difference of the amount paid and amount received by all customers is the source of profits of a firm.
 - ⑤ Professional knowledge such as theoretical rationales of options transactions is required to make reasonable judgment.
 - ⑥ Other matters to which particular notice shall be given.

(2) Disclosure of macroscopic profit and loss performance record of all customers

(2) With respect to over-the-counter binary option transactions with individuals, it is necessary to provide investors with opportunities to recognize the risk of loss associated with transactions concretely in order to gain the status of sound financial instruments transactions and requirements shall be provided as self-regulations for publishing the following matters regarding the state of the firm through the website, etc. each month.

- The ratio of the total amount of customers' profit to the total amount of trading value of transactions with customers.
- The ratio of the number of customers who suffered losses to the number of customers who made transactions.

(3) Appropriate advertisement

(3) With respect to over-the-counter binary option transactions with individuals, self-regulations shall be provided for the following matters regarding advertisement not to give investors excessive expectation or wrong recognition through advertisements.

- The advertisement shall aim providing knowledge necessary to conduct transactions and limiting to matters which contribute to appropriate investment by investors, and a Member shall ensure the thorough compliance therewith by means of advertisement examination by the Member.
- Representation to cause false understanding of the nature of the instruments or risks or to lead customers to easy investment shall be prohibited, and such approach of advertising shall be restrained.
- In using affiliate advertising, the Member shall use examination standards similar to those applicable to advertising by the Member in respect of contents to be used, and confirm the details fully.

With respect to representation, etc. which should not be used for advertisement, concrete measures shall be taken such as amendment to Advertisement Q&A prepared by the Association.

Principle 2. Matters regarding “restraining of excessive trading”

(1) Criteria for commencement of trading in light of knowledge, experience and financial resources of customers

(4) Self-regulations shall be provided for the following matters regarding criteria for commencement of trading and control and update of information of customers.

- The matters in the following ① to ⑥ shall be recorded in a Customer Card. A Member shall confirm with such customer at least once a year whether there has been a change in registered information in the card.

① Years of investment experience regarding derivatives transactions;

② Level of knowledge regarding over-the-counter binary option transactions.

③ Amount of financial assets holding and revenue.

④ Purpose of investment.

⑤ The upper limit of trading amount or the limit of loss declared by a customer.

⑥ Other matters required for a Member to judge the suitability of a customer for over-the-counter binary option transactions.

- Criteria for commencement of trading shall include the matters referred to in ① to ③ and ⑥. Each Member shall establish concrete judgment criteria such as value regarding such matters and ensure thorough enforcement of procedures prior to commencement of trading to keep from trading with customers who fail to meet such criteria.

- The matters referred to in ④ and ⑤ shall be used for restriction of trading or monitoring of trading after the commencement of trading.

- A Member shall confirm by means of question-and-answer whether the customer has required knowledge in order to support the judgment in respect of ② above. (The Remarks under the Regulatory Principle 1 (1) above shall be included.)

The Guidelines shall provide that hedging shall be included in the selection to the above ④ purpose of investment.

(2) Upper limit of trading amount, amount of loss, amount of position holding according to the attributes of customers such as financial, etc. resources, and monitoring of trading, etc.

(5) Self-regulations shall be provided for the following matters for the

purpose of thorough implementation of setting and control of the upper limit of trading amount, amount of loss and amount of position holding (hereinafter collectively referred to as “amount of trading limit”).

- A Member shall classify customers according to the substances of customers such as financial resources and determine the upper limit of trading according to each substance appropriately.
- A Member shall set the upper limit of trading effective in order to prevent excessive losses with investors and to prevent excessive speculation.
- A Member shall implement the system to control the upper limit of trading.
- A Member shall, in a timely manner, take necessary measures such as suspension of trading with a customer whose trading amount, amount of loss and amount of position holding exceeds the upper limit of trading.
- A Member shall confirm hedged assets or amount thereof in respect of a customer whose purpose of trading is “hedge”.

The Association shall describe in the guidelines the summary of the method of controlling the upper limit of trading in order to ensure that each Member may implement the business system smoothly.

Principle 3. Matters regarding “instrument design to contribute to the protection of customers and customers’ interests”

(6) Self-regulations shall be provided for the following matters regarding trading period, etc.

- A Member shall establish a sufficient period for a trading period (the period for entering into transactions between the Member and a customer).
- A Member shall establish a sufficient period for an interval of each trading term for instruments with the same trading conditions.
- A Member shall add strike prices to ensure, for the period from the time of the addition till the trading term, the period sufficient as equivalent to the trading period.

“Period sufficient” above shall mean two hours for the time being and shall be shown in the Guidelines.

※ Refer to Schedule 1: “WG Opinions regarding Trading Period and Intervals of Trading Terms, etc.”

- (7) Self-regulations shall be provided for the following matters regarding strike prices
- A Member shall determine strike prices to be used commonly by all customers before the commencement of each trading period. (It is not allowed to use such method as using the foreign exchange rate as at the receipt of an order to determine a strike price each time of the receipt of an order from a customer.)
 - Addition of strike prices shall be allowed as an exception only when trading with a customer cannot be conducted smoothly by using any of strike prices already released, although adding strike prices is not prohibited.
 - A Member shall not, during the trading period, change strike prices already determined.
 - A strike price shall not differ from the foreign exchange rate at the time of determination of the strike price significantly.
- (8) Requirements shall be provided as self-regulations for conducting over-the-counter binary option transactions with individuals by choosing either of the following methods in order to delete trading conditions giving only the firm an advantage and enhance fairness of trading
- Method to provide a customer with the opportunities to make purchase transactions to establish new positions and sale transactions to establish new position simultaneously in respect of instruments having the same underlying assets, trading period and strike price.
 - Method to conduct transactions with customers by using the structure that delete conditions to result in the state that all customers suffer loss (method to prevent so called “winner (firm)-takes-all”).
- (9) Self-regulations shall be provided for the following matters in order to conduct transactions at a fair price throughout the trading period
- A Member shall conduct transactions at fair trade prices determined based on reasonable grounds.
 - A Member shall arrange quoting both purchase price and sale price simultaneously and facilitate the system to enable customers to confirm them.
 - A Member shall keep the payout amount at a fixed amount during a trading period and show any change in option value by trade price.
 - A Member shall respond to a request for transactions (including

transactions to close open positions of customers) by customers to the extent possible until the trading term.

Principle 4. Matters regarding “providing appropriate trading conditions

(1) Disclosure of grounds for computation, etc. of trading conditions

(10) Self-regulations shall be provided for the following matters in order to ensure that investors understand trade prices fully and enable customers to make investment with reasonable judgment.

- A Member shall describe reasonable grounds for trade prices as a part of the summary of transactions in the Explanatory Guide and explain to customers about the details thereof fully.
- A Member shall explain to customers about grounds for determination of strike prices and judgment prices as a part of the summary of transactions in a similar manner as the above.

Self-regulations shall provide that a Member shall publish the summary of transactions to bring it to the attention of the public through its website, etc. and the Guidelines shall clarify the method for explanation (for example, using tables and charts) that, among others, the summary of transactions shall include the providing of interpretation, etc. to enable customers to understand fully about trade prices.

(2) Informing all customers regarding suspension of trading (so called, “sell-out”) and monitoring

(11) Although trading should not be suspended in principle because it means discontinuation of services and suspension of liquidity supply to customers, self-regulations shall be provided for the following matters considering the influence on investors because it is difficult to exclude such suspension completely.

- A Member shall not suspend or delay trading with customers without reasonable cause.
- A Member shall assume special reasons which may force the member to suspend or delay trading with customers, and explain to customers about the summary thereof and judgment criteria in the case of suspending trading in advance.
- If trading has been suspended or delayed, a Member shall publish through its website, etc., and explain to customers, about the fact and

the reason therefor, and retain documents of such suspension or delay.

- Each time when trading has been suspended or delayed, a Member shall require a division other than a division in charge of the trading to find out the reason therefor and monitor the appropriateness thereof and ensure prevention of reoccurrence.

(3) Retention of Data regarding trading conditions and monitoring

(12) Considering, with respect to over-the-counter foreign exchange margin transactions, the fact that self-regulations have been provided for the retention of data of distributed prices and verification to maintain the appropriateness of prices, similar self-regulations shall be provided for the following matters in respect of over-the-counter binary option transactions with individuals.

- A division other than a division in charge shall verify the appropriateness of trading prices.
- A division other than a division in charge shall verify that judgment prices are not determined by false value distributed by mistake or fraudulent value created arbitrarily.
- A Member shall apply self-regulations for foreign exchange margin transactions to over-the-counter binary option transactions with individuals and retain trade prices and other necessary data for three years.

Other Matters in Final Report

Establishing self-regulations for trading period or other specifications of over-the-counter binary option transactions with individuals as described in the Regulatory Principle 3 “Instruments design contributed to the protection of customers and customers’ interests” meets the purpose of the articles of incorporation of the Financial Futures Association of Japan, and obtaining understanding from investors and business operators and stable self-regulatory activities are required.

For such reason, we would like to express our desire that such self-regulations for instruments specifications shall be covered by the Financial Instruments Act and regulations to provide for concrete operating method within the scheme of the Financial Instruments Act and related regulations.

**Financial Futures Association of Japan
Binary Option Working Group**

Members

FXTrade Financial Co., Ltd (Chair)
Matsui Securities Co., Ltd
Rakuten Securities, Inc.
GMO CLICK Securities, Inc.
TRADERS SECURITIES Co., LTD
Monex, Inc.
Saxo Bank FX Securities K.K
IG Securities Limited
FX PRIME CORPORATION
Central Tanshi FX Co., Ltd.
GAIAME.COM CO., LTD.
CyberAgent FX, Inc.
Hirose Tusyo Inc.
MONEY PARTNERS Co., LTD.
Kakaku.com Financial, Inc. (First and Second)

Observers

Financial Services Agency
Tokyo Financial Exchange Inc.
Osaka Securities Exchange Co., Ltd.
Japan Securities Dealers Association (Fourth to Tenth)

Administration

Financial Futures Association of Japan