ASX

4 October 2019

OTC Intermediary Compliance
Market Supervision
Australian Securities and Investments Commission
Level 7, 120 Collins Street
MELBOURNE VIC 3000

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

Re: Response to ASIC Consultation Paper 322 – Product intervention: OTC binary options and CFDs

Thank you for the opportunity to comment on the proposal to ban OTC binary options and impose certain conditions on the issue and distribution of OTC CFDs to retail clients.

ASX does not believe that the proposed measures will have a material impact on the operation, or integrity, of public markets in the underlying securities on which some of these products are based. The extent to which providers of these products hedge their exposures through public markets is not clear but it is likely to be relatively limited, so the impact on overall trading activity is not anticipated to be significant.

ASX notes ASIC's analysis that there has been significant growth in these lightly-regulated OTC products over recent years, and that they have been associated with significantly detrimental outcomes for a large number of retail investors.

As a general comment, it is important that ASIC's product intervention power is only used after a careful assessment of the features and outcomes for investors and where there is clear evidence that the product (or class of products) is not suitable for retail investors. In such cases, the policy objective of limiting retail access to such products, based on actual or likely outcomes they deliver to investors, is reasonable.

It is acknowledged that when ASIC's new design and distribution obligations are in place there should be less need for the product intervention power, given harmful products should not generally reach the hands of retail investors. This will bring the treatment of these OTC retail products somewhat closer to exchange-traded products, which are subject to a thorough regulatory review before being made available to retail investors.

Exchange-traded products also have additional layers of investor protections over equivalent OTC products.

- OTC products are governed by contractual arrangements between the product provider and client and there can be discretion as to how the arrangements are applied. In contrast, exchange-traded products are normally governed by the market's operating rules (product specifications, trading rules and price formation). These operating rules are subject to regulatory review and approval before coming into effect.
- There is a higher level of supervision and surveillance of participants operating in a regulated market environment, and there is not the aggressive selling and marketing practices that have been observed amongst OTC retail products.
- There is greater transparency in trading markets. Market operators are required to ensure the markets are fair, orderly and transparent, and that they have adequate resources to manage the market.
- The counterparty risks associated with exchange-traded products are lower as trades are generally novated to a central counterparty which has in place measures to meet its obligations, compared to risks associated with exposures to an OTC provider.
- It can be more difficult, or costly, to liquidate OTC positions during periods of adverse market conditions.

The consultation paper noted that while the current proposals relate to OTC binary options and CFDs there are other (OTC and exchange-traded) leveraged products which are issued to retail clients and which exhibit similar characteristics or risks. Exchange-traded products are different in a number of key respects to similar OTC products, including the differences set out above.

ASIC has identified that high leverage ratios are unsuitable for retail investors. While some products listed or quoted on a licensed market, for example derivatives and exchange traded funds, may provide leveraged exposure, the extent of that leverage is significantly lower than the OTC examples quoted in the current ASIC consultation.

Derivative products can be used to manage risk and their leveraged characteristics can provide a cost effective hedging tool. Further, leveraged funds can be an element of a diversified investment portfolio.

ASIC's consideration of future market-wide product intervention orders should carefully consider how any products under review are used as part of a well-managed portfolio.

Yours sincerely

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