ASIC Proposed OTC CFD product intervention

Pepperstone Group Limited

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Contents

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Glossary

Acronym or abbreviation	Full name
AFSL	Australian Financial Securities Licence
ASIC	The Australian Securities and Investments Commission
Association, The	Australian CFD and Margin FX Association
CFD	contract for difference
CFTC	Commodity Futures Trading Commission
CSA	Canadian Securities Administrators
EA	Expert Advisor
ESMA	European Securities and Markets Authority
FCA	Financial Conduct Authority
FSS	Financial Supervisory Service
GFC	Global Financial Crisis
KNF	Komisja Nadzoru Finansowego (Polish Financial Supervision Authority)
MAS	Monetary Authority of Singapore
OTC	over-the-counter
SFC	Securities and Futures Commission

Executive summary

The contracts for difference (CFD) market has grown rapidly, bringing benefits and negative impacts too. The Australian Securities and Investments Commission (ASIC) wants to minimise the risk of significant detriment to retail clients. ASIC's proposals to reduce potential financial losses by traders – most notably, the introduction of leverage ratio limits – will also reduce potential financial gains for traders. To help inform ASIC's decision making, Pepperstone Group Limited (Pepperstone) engaged Deloitte Access Economics to undertake a study and prepare a report examining the potential impact of some of the proposed restrictions on the market for CFDs for inclusion by it in the submission of the Australian CFD and Margin FX Association.

Regulators in other jurisdictions have implemented measures similar to those proposed by ASIC however, the public record of the impact and effectiveness of these measures is sparse. Consequently, this report aims to flesh out the record with new information provided by Pepperstone and other members of the Australian CFD and Margin FX Association (the Association), a group of Australian-based brokers that account for approximately 70% of the Australian CFD market.

The information gathered for this report includes:

- a review of impacts of measures similar to those proposed by ASIC in other jurisdictions
- a survey of more than 2,000 Australian-based retail clients of CFD brokers
- interviews with 18 CFD traders
- analysis of de-identified client trading data.

The information presented in this report indicates this cohort of CFD traders:

- exhibit different characteristics – e.g. in terms of years of experience, approach to trading, level of income – that may affect their likelihood of experiencing significant detriment
- are likely to respond in different ways to the proposed measures, such that there is uncertainty around the net impact of the measures
- could move their trading activity to markets where ASIC's protections do not apply.

Key findings

Information on retail clients revealed a picture of diversity of experience, income, occupation, frequency of trading and other dimensions:

- Few traders used leverage below ASIC's proposed limits.
- The level of leverage was a function of traders' experience.
- Expert Adviser (EA) tools tended to be used by more experienced traders, but much trading is manual.

International evidence from countries where restrictions apply similar to those proposed for Australia is mixed:

- Trading volumes are reduced.
- Margin requirements appear to reduce liquidity, but not widen spreads.
- The impact on trader's losses is less clear; for example, the findings in the US not being replicated in Poland.

The proposed restrictions will have impacts on Australian-based brokers and traders:

- Brokers are likely to have a reduced client base, with fewer brokers remaining in the market, higher costs and reduced risk in the market.
- Traders may leave in search of higher leverage, going offshore including to unlicensed brokers.
- It is hard to discern what else will happen, for example, to trader's loss ratios.

CFD traders

ASIC estimates that the Australian over the counter (OTC) binary options and CFDs market had gross annual turnover of about $22 trillion in 2019, with approximately 79% of transactions being for CFDs. ASIC estimates that trading in this market is carried almost exclusively (99%) by traders classified as retail clients.[1]

Australian-resident retail clients of four CFD brokers – FP Markets, GO Markets, IC Markets and Pepperstone – were surveyed via a digital tool provided by Deloitte between 19 September and 4 October 2019. Of the 2,139 respondents:

- 68% of traders had two or more years of experience, while 6% had less than six months
- 47% of traders had pre-tax income of more than $85,000 p.a. and 10% had income of $35,000 p.a. or less, while 16% did not provide an income figure
- traders with higher levels of income and more years of experience, on average, reported using higher levels of leverage and traded more frequently.

Telephone interviews with retail clients revealed additional information, including that:

- some traders manually enter their trades, while others utilise Expert Adviser (EA) tools
- traders require sound risk management skills to succeed, acquired by undertaking training courses and through experiencing market fluctuations over an extended period.

CFD brokers

There are 65 brokers licensed by ASIC to issue and distribute CFDs and binary options in Australia. There are also perhaps 300 unlicensed brokers, as well as brokers operating in offshore markets – this report does not look at the characteristics of these brokers.[2] Some interviewees said they prefer to operate in a well-regulated market, like Australia, but others choose a broker based on the level of leverage available.

The six brokers– AxiTrader, Eight Cap, FP Markets, GO Markets, IC Markets and Pepperstone – reported combined CFD turnover of $12.68 trillion in their most recent financial years; none offer binary options.[3]

These brokers provided information for this report, showing:

- they employed 357 people
- paid over $180 million in tax in their most recent financial year.[4]

Pepperstone estimates the industry, in total, has around 1,000 Australian-based employees and paid about $400 million tax.

Impact of changes to leverage

ASIC is proposing to reduce leverage ratios offered to retail clients. International experience showed leverage caps contributing to reduced losses and traders leaving the market in search of higher leverage. It is not possible to be certain of how traders fared in the new markets, based on the limited publically-available information.

Survey responses indicated that lower leverage ratios would:

- cause many traders 64% to move to a broker that offered higher leverage
- change the size and frequency of trades, with more traders decreasing the size and frequency of their trades rather than increasing
- have no effect on style of trading or choice of broker for 10% of traders

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[1] ASIC 'Product intervention: OTC binary options and CFDs' (Consultation Paper 322), August 2019, < https://asic.gov.au/regulatory-resources/find-a-document/consultation-papers/cp-322-product-intervention-otc-binary-options-and-cfds/> – Only CFDs – numbers derived from percentage of total trades.
[2] ASIC, various media releases 2016, 2017.
[3] Company data provided to Deloitte Access Economics. Includes retail and wholesale client's data.
[4] Company data provided for this report.

- force 9% to stop trading.

Through the consultations it was evident that clients are apprehensive about moving to an offshore broker, due to counterparty risk and the lack of the protection for retail clients, however, some felt it may become a necessity. Many believed that the leverage restrictions would only exacerbate the losses by forcing clients offshore to markets with fewer consumer protections. Clients may also consider seeking 'wholesale' client status to avoid the limits.

Impact of changes to margin close-out

ASIC is proposing to require brokers to begin closing out retail client's open positions when their margin falls to less than 50%. Some interviewees questioned how effective this would be as ASIC would also be instituting negative balance protection, which some brokers already offer. International experience indicates the measures would reduce the amount of debt forgiveness given to retail clients.

Overall, however, survey respondents were in favour of some level of margin close out protection, with:

- 27% supporting ASIC's proposal of a 50% close out
- 39% favouring a 20% close out.[5]

However, 27% are against margin close out at any level.

Model simulations

De-identified trading data provided by Pepperstone analysed for this report revealed:

- introducing leverage cap rules in the UK is associated with customers moving to other jurisdictions where the new leverage rules did not apply
- a higher stop-out percentage limits both the profits and the losses of accounts compared to those accounts that have lower stop-out percentages.

Limitations of this report

The data gathered for this report comes from a sample of six brokers that, between them, may account for about 70% of the CFD trading in the Australian market, and their Australian-based retail clients. However, the key findings are not representative of the entire market, because the analysis excludes, for example, unlicensed brokers, brokers offering binary options and retail clients based overseas who trade in the Australian market.

Conclusion

Based on the information gathered and presented in this report, it appears that ASIC's proposals are likely to reduce losses for a subset of retail clients with a consequent impact on the market which warrants further investigation before such proposals are implemented because:

- the survey of brokers' retail clients reveals a picture of diversity, across a number of dimensions that may influence traders' outcomes
- the international evidence on the impact of restrictions shows that traded volumes decrease, but the impact on traders' losses is less clear; e.g. are individuals losing less because they are investing less, or are they losing a smaller share of the amount they invest
- the proposed restrictions will have impacts on Australian-based brokers and traders, including reducing risk in the market and traders leaving the market in search of higher leverage
- there may be groups of profitable traders that will be adversely affected by the proposed measures
- it is hard to discern what else will happen and what unintended consequences may occur.

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[5] Pepperstone suggests 20% is a proxy for the current close out level employed by brokers.

1 Introduction

Key definitions

CFD: A contract on the difference between the opening and closing price of an asset.
CFD broker: An issuer or distributor of CFDs.
CFD trader: A buyer or seller of CFDs, typically a retail client of a CFD broker.

1.1 Motivation for this report

The market for contracts for difference (CFDs) in Australia has grown considerably over the past few years. Surveys of brokers licensed in Australia undertaken by the Australian Securities and Investments Commission (ASIC), indicate the number of annual trades in CFDs and binary options increased from 236 million (of which 85% where CFDs) in 2017 to 675 million (79% CFDs) in 2019, while the value of these trades (gross annual turnover) doubled to $22 trillion.[6] Of the 1 million CFD and binary options traders in 2019, 17% were based in Australia and 99% were classified as retail clients.[7]

ASIC considers that CFDs result in significant detriment to retail clients.

> *We consider that binary options and CFDs have resulted in, and are likely in future to result in, significant detriment to retail clients, primarily financial losses.*[8]

Following the lead of several other jurisdictions, ASIC is proposing to impose conditions on the issue and distribution of CFDs to retail clients. ASIC would put these conditions into place using its product intervention powers under Pt 7.9A of the *Corporations Act 2001*.

The proposed measures would curtail some practices that carry both the risk of large financial losses and the chance of making large financial gains. Consequently, the impact of the proposed measures on individual CFD traders will be influenced by factors such as their approach to managing risk in trading and their capacity to absorb losses.

Australian-resident retail clients of four CFD brokers – FP Markets, GO Markets, IC Markets and Pepperstone – were surveyed for this report. Collectively, the members of the Association currently support approximately 70% of turnover in the retail CFD market:

- assuming CFD market turnover of $17.4 trillion p.a., based in ASIC's industry data for 2019
- compared to the members of the Association's reported combined turnover of $12.68 trillion in their most recent financial year.[9]

None of these brokers offer binary options to clients, retail or wholesale.

Pepperstone engaged Deloitte Access Economics to undertake a study of the potential impact of the proposed restrictions on leverage on markets for CFDs, and summarise this in a report. The report will be included in a submission made by the Association to ASIC, in response to *Consultation Paper 322 Product Intervention: Binary options and CFDs*. This report aims to provide ASIC with a better understanding of the potential impact of the proposed product intervention in CFD markets.

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[6] ASIC 'Product intervention: OTC binary options and CFDs' (Consultation Paper 322), August 2019, < https://asic.gov.au/regulatory-resources/find-a-document/consultation-papers/cp-322-product-intervention-otc-binary-options-and-cfds/> – Only CFDs – numbers derived from percentage of total trades.
[7] *Ibid*
[8] *Ibid*
[9] Data provided by the Association.

Notably, this report provides new information on the impact that the proposed measures may have on Australian-based retail clients of CFD brokers, and on other stakeholders, based on a survey of brokers' retail clients, interviews and de-identified trading account data.

1.2 Approach

The study presents information from the members of the Association, which between them may account for about 70% of market turnover, to demonstrate that there are different cohorts of traders in the market and, consequently, while the proposed measures may have clear benefits for some groups of traders, the impact may be different for other groups.

1.3 Objective of the report

The objective of this report is to:

- paint a picture of the diversity of the CFD market participants
- present a summary of the international experience of restrictions on CFDs similar to those being proposed for Australia
- consider the potential impact on traders and brokers in Australia.

1.4 Data sources

As part of this research, Deloitte Access Economics has compiled evidence from a range of sources, including:

- official reports from regulators in different jurisdictions, e.g. ASIC in Australia and the Financial Conduct Authority (FCA) in the UK
- industry news reports, e.g. LeapRate.com and financefeeds.com
- a survey of Australian-based CFD broker retail clients of, with 2139 responses
- selected responses from interviews with 18 Australian-based CFD traders, who are clients of FP Markets, GO Markets or Pepperstone
- modelling of de-identified trading account data, provided by Pepperstone.

1.5 Report contents

The rest of this report is structured as follows:

- **Chapter 2** presents information on Australian-based retail clients of a group of ASIC-licensed CFD brokers, highlighting trader's characteristics such as their preferred leverage and their income.
- **Chapter 3** discusses aspects of the CFD broker industry in Australia.
- **Chapter 4** considers the proposed ASIC leverage ratio limits and their potential impact on the CFD market, including trading behaviour and outcomes for traders and other market participants.
- **Chapter 5** focuses on the proposed ASIC margin close-out protection rule and its potential impact on the CFD market.
- **Chapter 6** presents the results of an attrition simulation analysis, estimating the potential number of retail clients who would be affected if the proposed ASIC measures were to come into effect.
- **Chapter 7** presents the report's conclusions.
- **Appendix A, Appendix B and Appendix C** provide further information on the survey, interview questions and simulation modelling conducted for this report.

2 CFD traders

Key points

The surveys and interviews with Australian-based traders from the sample of ASIC-licensed brokers shows:

- 68% of traders have more than two years' experience
- 47% earn above-average incomes
- 58% use leverage levels of 150:1 or higher
- 66% trade at least once a day, on average
- EA tools are increasing in popularity due to convenience.

The vast majority of CFD traders (99%) are retail clients of CFD brokers. Whilst the reasons for trading CFDs vary between clients, it is the apparent simplicity of the product, availability of platforms and support, and access to leverage that make CFDs an attractive option for retail investors.

> *I started with CFDs because they are a reasonably easy product to understand. Now, however, leverage is the primary reason I trade these products.*
>
> *(Anonymous CFD trader)*
>
> *CFDs offer good platforms and functionality, support and lower costs of execution.*
>
> *(Grant Rogers, CFD trader)*

Retail clients, however, are not a homogenous cohort with survey results and consultations suggesting these clients have a wide range of experience, sophistication, income and, ultimately, success.

This chapter presents information on a sample of Australian CFD traders that are clients of members of the Association. The chapter draws on public reports from government and industry, a survey and interviews with retail clients, and information from CFD brokers.

- The survey was sent to Australian-based retail clients of four brokers – FP Markets, GO Markets, IC Markets and Pepperstone – for two weeks in late September and early October, with 2139 clients completing the survey. These brokerages account for a substantial share of the market, and they are licensed by ASIC and based in Australia (see Chapter 3).
- Interviews were conducted in September, with retail clients selected from a list of contacts provided by three brokers – FP Markets, GO Markets and Pepperstone.

Limitations of the data

The data gathered for this report come from a sample of Australian-based, ASIC-licensed brokers that account for much of the CFD trading in the Australia market, and their Australian-based retail clients. As such, the key findings will be reflective of characteristics of this group. However, the findings are may not be representative of the entire market, because the analysis excludes unlicensed brokers, brokers offering binary options and retail clients based overseas who trade in the Australian market.

Who is a "retail client"?

Under the *Corporations Act 2001* (Cth), a person acquiring a "financial product or service" can either be categorised as a "retail client" or a "wholesale client". In the specific context of CFDs:

- Most individuals and businesses trading CFDs are generally presumed to be a **"retail client".**[1]
- Generally, firms have not distinguished between retail and wholesale status, with all clients classified as retail by default. Historically, there was no advantage for traders to be classed as wholesale. Rather, there is a disadvantage in clients losing their retail client protections.[2]
- An individual or business may, however, be deemed a **"wholesale client"**, if:
  a. the price or value of the CFD is over $500,000,
  b. the CFD is being used in connection to a business that is not a "small business" (i.e. a business employing less than 100 people in the manufacture of goods or 20 people otherwise),
  c. the individual has net assets worth over $2.5 million or gross income greater than $250,000 in the last two financial years,
  d. the individual is a "professional investor",[3] or
  e. the individual is a "sophisticated investor" according to an "Australian financial service licensee" (AFSL) provider.[4]

There are benefits to being classified as a "retail client" under the *Corporations Act 2001* (Cth). As "retail clients" are regarded as less financially sophisticated compared to "wholesale clients", retail clients are entitled to greater consumer protections under the Act. Retail clients, for example, must receive a Financial Services Guide (FSG), Statement of Advice (SOA) and where appropriate, a Product Disclosure Statement (PDS) when acquiring any financial product or service. Wholesale clients, in contrast, are not required to receive any of these documents.

1 *Corporations Act 2001* (Cth), s 761G(1).
2 Pepperstone
3 *Corporations Act 2001* (Cth), s 761G(7); *Corporations Regulations 2001* (Cth) regs 7.1.18-7.1.28.
4 *Corporations Act 2001* (Cth), s 761GA.

2.1 How much experience do traders have?

The rapid growth of the CFD market between 2017 and 2019 suggests that many retail clients will have less than two years' experience of trading CFDs. This lack of experience was not reflected in the survey, suggesting that this substantial growth could be coming from offshore traders.

A majority of respondents to the survey stated they have been trading CFDs for more than two years. Chart 2.1 shows that 68% of respondents surveyed reported that they have been trading CFDs for over two years.[10] Only Australian-based traders were surveyed, so this suggests that most of the growth in the market is from traders based offshore.

> *One of the best things about experience is that you pick up on all your emotional hints. You need to be able to work out your impulses and learn to override them.*
>
> *(John Francis Kelly, CFD trader)*

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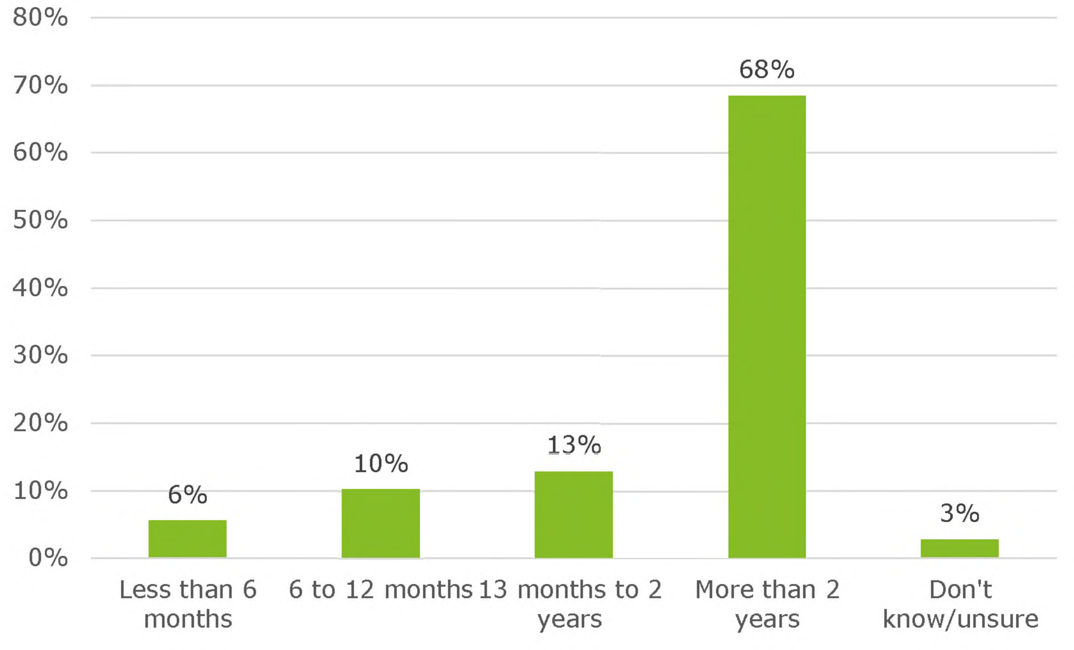
[10] Deloitte Access Economics and DTermine, CFD Survey 2019.

Chart 2.1: Trading experience of CFD retail clients



Source: Deloitte Access Economics and DTermine, CFD Survey 2019 (2019).
Note: Survey respondents were asked "How long have you been trading CFDs?" and given five choices; "Less than 6 months", "6 to 12 months", "13 months to 2 years", "More than 2 years" and "Don't know/unsure". Sample = 2,139 responses.

Within the consultations, experience meant different things for different people. Some clients had a background in financial markets and saw CFD trading as a natural extension of their profession.

> *I have been an equities trader for the past six years. My job involves me managing money and risk on behalf of the firm's money and I saw no reason why I couldn't do this for myself.*
>
> *(Anonymous, CFD trader)*

For others, CFD trading has involved more development and investment. Some participants have tried and experienced numerous products and markets and have found CFDs to be a simple and effective short term investment tool.

> *I have been trading CFDs now for three years. I started on FOREX with limited success until a friend of mine suggest I move to [equity] indices.*
>
> *(Tim Highett, CFD trader)*

For these clients, many have invested in their own development, education and understanding of the market.

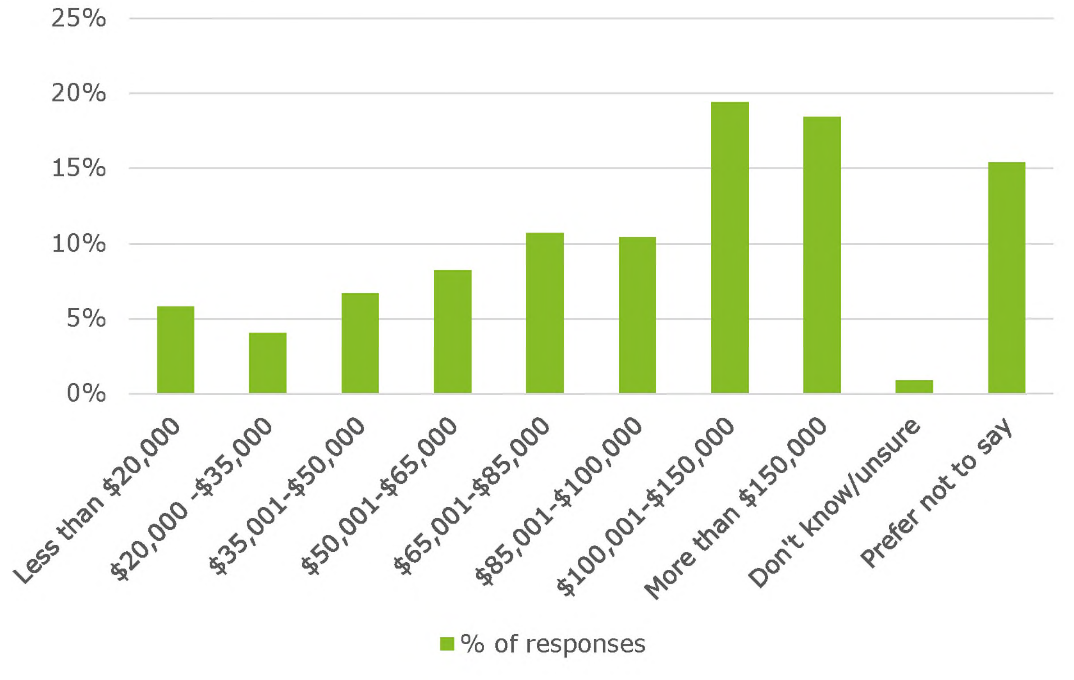
> *ASIC's proposed changes do not acknowledge the time, money and effort some have put into making trading a viable source of income and now the rug is being pulled from beneath us.*
>
> *(Herve Nayna, CFD trader)*

2.2 What is the income distribution of traders?

With 38% of CFD traders being under 30 years of age in the ASIC 2019 survey, it might be expected that the income distribution of these traders would be skewed towards lower income bands.[11] Indeed, ASIC *Consultation Paper 322* reported that 32% of binary option and CFD clients from a sample of 61 brokers with an Australian Financial Services Licence (AFSL), earned less than $37,000 in annual income.[12]

In contrast, the survey of retail clients found 10% earned $35,000 or less in annual income (see Chart 2.2). With a median income bracket of $85,000-$100,000, 47% of the sample said they earned a pre-tax income greater than the average annual income for a full-time adult working in Australia ($85,000).[13]

Chart 2.2: Income distribution of CFD retail clients



Source: Deloitte Access Economics and DTermine, CFD Survey 2019 (2019).
Note: Survey respondents were asked "What is your total annual pre-tax income, from all sources?" and given eight possible income bands; "Less than $20,000", "$20,001 - $35,000", "$35,001 - $50,000", "$50,001 - $65,000", "$65,001 - $85,000", "$85,001 - $100,000", "$100,001 - $150,000" and "More than $150,000", as well as a "Don't know/unsure" option and "Prefer not to say" option. Sample = 2,139 responses.

This income distribution was corroborated by consultations; of 18 traders interviewed, all claimed a pre-tax income of more than $85,000. Primary professions included:

- Financial analyst
- Engineer
- Farmer
- Real estate agent
- Airline pilot

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[11] ASIC 'Product intervention: OTC binary options and CFDs' (Consultation Paper 322), August 2019, < https://asic.gov.au/regulatory-resources/find-a-document/consultation-papers/cp-322-product-intervention-otc-binary-options-and-cfds/>
[12] *Ibid.*
[13] Australian Bureau of Statistics (ABS), *6302.0 – Average Weekly Earnings, Australia, May 2019* (23 September 2019) <https://www.abs.gov.au/ausstats/abs%40.nsf/mediareleasesbyCatalogue/030E8BEF4B0B915ECA2582EA00193B04?OpenDocument>. The average weekly ordinary time earnings for a full-time adult as of May 2019 was $1,634. This translates to an average annual income of $1,634 x 52 = $84,968.

- Cash equities trader
- Port worker
- Tax accountant

A number of the participants surveyed indicated that they had begun as 'lifestyle investors' – investors seeking to supplement a full time income – and rely, or plan to rely, on trading to fund retirement.

> *Currently I work as a pilot, but I will not be able to fly forever. I had hoped to make trading a viable alternative later in life but these measures are threatening that.*
>
> *(Tim Highett, CFD trader)*

2.3 What are some of the different approaches to trading?

Retail clients vary widely in their approaches to trading, from the leverage ratio they use to the frequency of their trading.

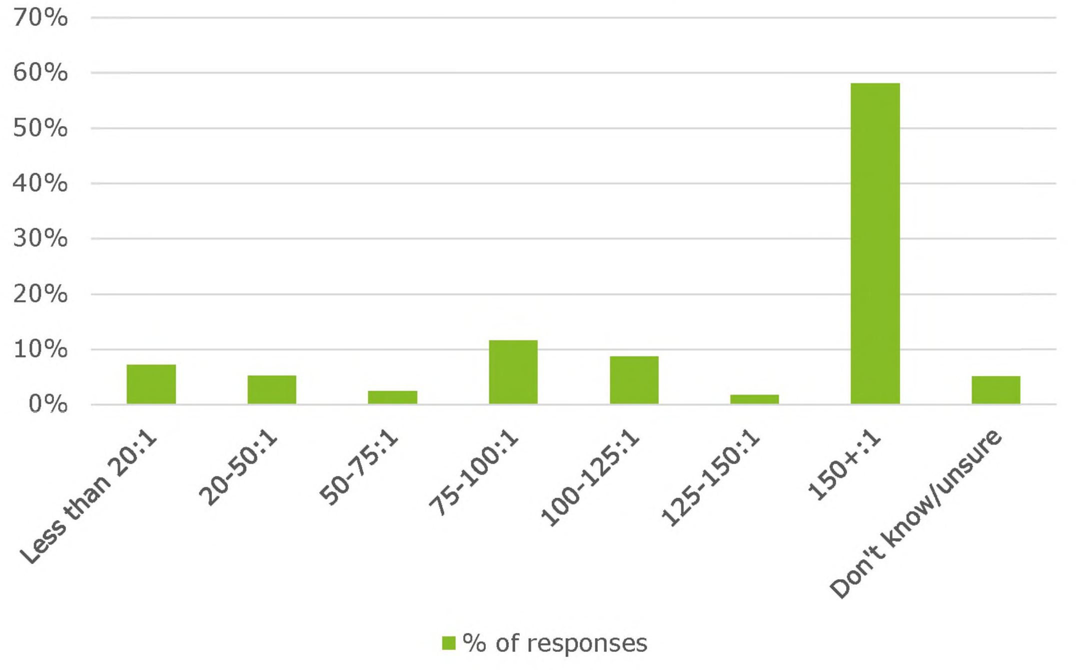
2.3.1 Leverage

Depending on the type of CFD being traded, leverage ratios range from as low as 1:1 (i.e. no leverage) to as high as 500:1.[14] Brokers and traders generally determine the appropriate level of leverage by the volatility of the underlying asset. Volatile assets generally attract a lower leverage ratio due to the increased likelihood of significant movements in the underlying asset price. For less volatile asset classes, leverage allows investors to magnify the upside benefit (and downside loss) for a given level of investment. For this reason, the availability of leverage is one of the most important factors for traders choosing to trade CFDs.

Chart 2.3 shows the distribution of leverage ratios across the sample of retail investors. Some 58% of CFD retail clients surveyed indicated that they most often use an overall leverage of 150:1 or higher. Respondents choosing a leverage ratio of less than 20:1 account for only 7% of the total sample (see Chart 2.4). The maximum leverage limit allowed under ASIC's proposed limits is 20:1 for FX products, and lower limits – down to 2:1 – are proposed for other products.

[14] A leverage ratio is the ratio between the total notional CFD position value and the amount required to be deposited by the retail client.

Chart 2.3: Leverage ratios used most often by CFD retail clients

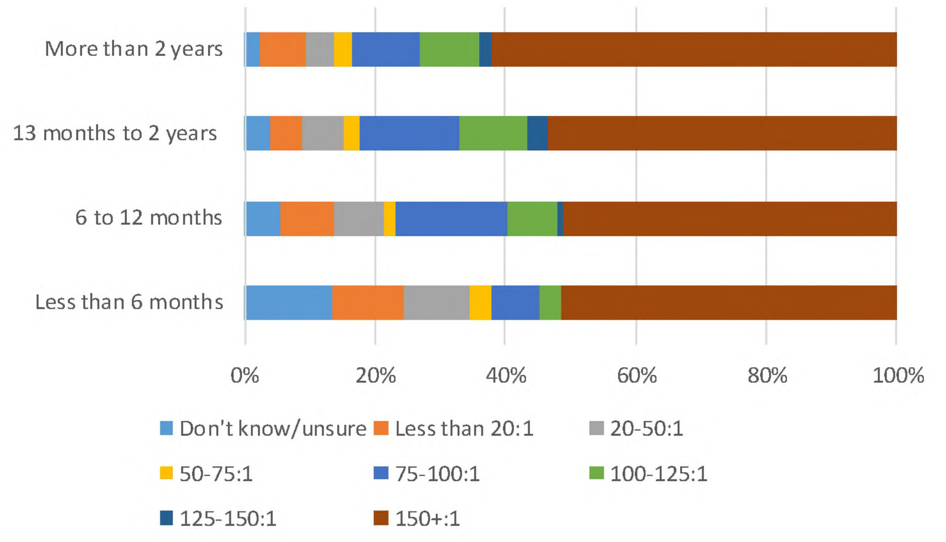


Source: Deloitte Access Economics and DTermine, CFD Survey 2019 (2019).
Note: Survey respondents were asked to "Select the leverage that you use most often" and given eight options; "Less than 20:1", "20-50:1", "50-75:1", "75:100-1", "100-125:1", "125-150:1", "150+:1" and "Don't know/unsure". Sample = 2,139 responses.

Chart 2.4 shows the leverage ratios most commonly used by clients, according to experience. Although it depends on the underlying asset these investors are trading, generally leverage and experience appear to be positively correlated. That is, with longer trading experience, more retail clients reported using higher leverage ratios more often:

- across all levels of experience, more than half of all respondents reported using a leverage ratio of 150:1 or higher
- 62% of traders with more than 2 years of experience reported most often using leverage rates of 150: 1 or higher
- 51% of traders with less than 6 months experience reported a preference for the highest bracket of leverage.

Chart 2.4: Leverage ratios used most often by CFD retail clients, by experience



Source: Deloitte Access Economics and DTermine, CFD Survey 2019 (2019).
Note: Survey respondents were asked to "Select the leverage that you use most often" and "How long have you been trading CFDs?", with options as described above in Chart 2.2 and Chart 2.3. Sample = 2,139 responses.

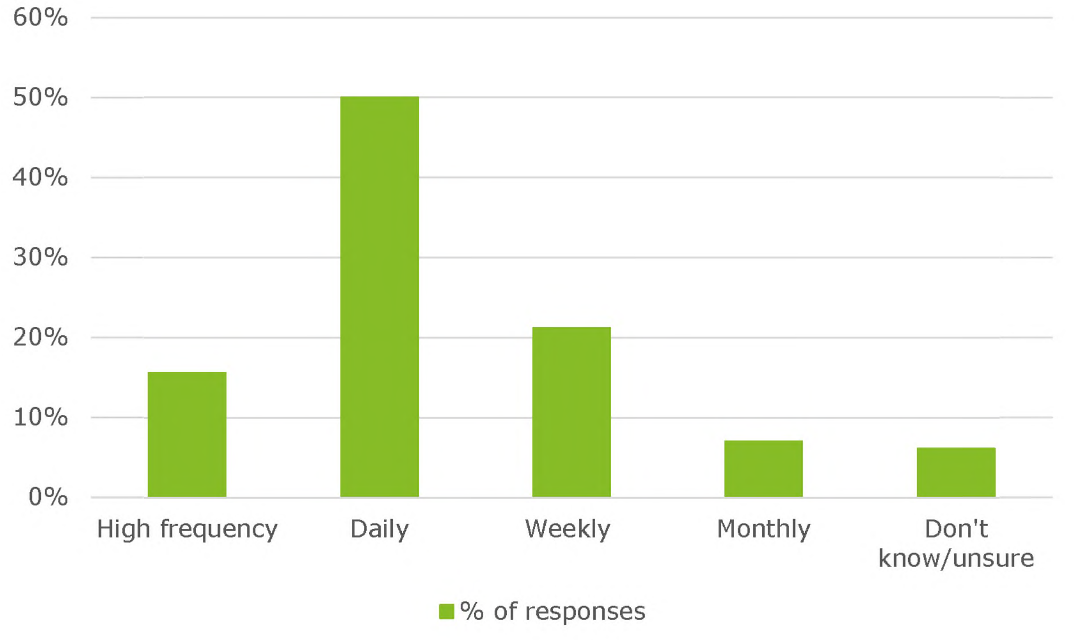
Consultation participants also identified a link between experience and higher levels of leverage. Traders mentioned that as they started out, they held conservative levels of leverage while they developed experience. As their knowledge of the underlying market improved, their preferred level of leverage would often increase.

> *When I started out I was probably averaging 50:1 across several trades, but the more trading I did the more I felt confident increasing my leverage. Now I average about 400:1.*
>
> *(Anonymous CFD trader)*

2.3.2 Frequency of trading

Unlike more passive, buy-and-hold trading strategies, such as equity trading, CFDs are generally seen as an attractive option for short-term investments. Chart 2.5 is consistent with this level of required engagement, suggesting that 50% of retail clients are trading an average of once every day, with almost 16% trading at high frequency (more than once a day).

Chart 2.5: Frequency of trading amongst CFD retail clients



Source: Deloitte Access Economics and DTermine, CFD Survey 2019 (2019).
Note: Survey respondents were asked "How frequently do you trade CFDs?" and given five options; "High frequency", "Daily", "Weekly", "Monthly" and "Don't know/unsure". Sample = 2,139 responses.

Most clients interviewed as part of this report stated that they were trading at least once a day or more. However, trading did not always mean that they were placing or expiring positions on a daily basis, rather they were observing markets and looking for opportunity on a daily basis.

> *I might not trade every day, but I'm checking the screens at least twice daily and usually have a few positions on at any one time. If I don't see an opportunity that day, I don't trade.*
>
> *(Tim Highett, CFD trader)*

2.3.3 EA vs manual

Expert advisor (EA) trading involves utilising a personalised algorithm to execute trades on behalf of the client. Consultation participants suggested that EA tools were not yet the norm, but were gaining traction due to the flexibility they provided.

> *I switch on my EA tool on Sunday night and switch it off again on Friday. I'm very comfortable running it in the background while I go about my week.*
>
> *(Herve Nayna, CFD trader)*

EA tools do not replace the role of the trader and seem to be utilised by the more experienced clients. The EA traders consulted all had numerous years' experience and had accommodated the EA around their manual trading strategy. All of the EA traders consulted continued to trade manually, however, the tool is able to increase their volume and allows them to trade around the clock.

> *I got into EA trading because Asian markets don't have the same opportunity. I still trade manually throughout the day but with my EA I can trade Europe and America while I sleep.*
>
> *(Anonymous CFD trader)*

EA platforms are able to run of the basic MT4 trading software available through most brokers. The tools can be obtained through the brokers themselves for a fee or bought easily off the shelf from external program developers.

2.4 What does the 'average' trader look like?

While the 'average' trader may not exist, it can be useful to look at the 'average' or 'median' characteristics of traders to get a sense of the level of experience and trading behaviours common to the CFD traders that responded to the survey.

Using data from the CFD Survey 2019, a profile of the 'median' Australia-based trader was compiled and found to possess the following characteristics:

- an annual income of AU$85,001-100,000 – more than the average annual income of a full-time worker in Australia
  - this suggests that many of the lower-income earning retail clients in ASIC's survey are not trading with members of the Association or, if they do, they are not based in Australia
  - also, ASIC's survey includes traders of binary options
- more than two years of trading experience
- making trades on a daily basis, or more frequently
- using a preferred leverage ratio of 150:1 or more.

Figure 2.1: The 'average' trader and their characteristics

Source: Deloitte Access Economics and DTermine, CFD Survey 2019 (2019).

3 CFD brokers in Australia

Key points

- There are 65 licensed CFD and binary options brokers in Australia.
- Turnover for the industry is estimated to be $AUD 22 trillion per annum.
- The industry contributes approximately $AUD 400 million per annum in tax.
- There may be 300 unlicensed brokers operating in Australia.

CFD traders can trade with a range of issuers and distributors – collectively known as brokers. Brokers servicing traders may be based in Australia – licensed by ASIC or unlicensed – or they may be based overseas.

3.1 Licensed brokers

An AFSL is required for any business providing financial services.[15] Provision of financial services includes any company making a market for or dealing in financial products, which includes brokers of CFDs.

3.1.1 Number

Currently there are 65 companies providing CFDs (or binary options) that hold an AFS licence.[16] These licensed companies are regulated by ASIC and will be subject to any product intervention measures introduced.

3.1.2 Turnover

Annual turnover in the market for binary options and CFDs doubled to $22 trillion between 2017 and 2019, according to ASIC.[17] Some 79% of trades in 2019 were CFDs; excluding binary options and assuming the size of the average binary option trade and CFD trade is similar, turnover in the CFD market is $17.4 trillion. Members of the Association reported turnover of $12.68 trillion in their latest financial year.[18]

3.1.3 Taxes

Data provided for this report by the Association indicates that its members yielded a tax contribution of $184 million for the brokers' most recent financial year. This represents about 60% of an estimated total industry tax of about $400 million.[19]

3.1.4 Employment

Deloitte Access Economics received employment data from the six members of the Association. Together these brokers employ 357 people, compared to total employment which is estimated to be around 1000 people in the Australian market.[20] This estimate includes international firms operating in Australia.

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[15] Australian Securities and Investments Commission, *AFS licensees*, 20 October 2010, <https://asic.gov.au/for-finance-professionals/afs-licensees/>

[16] ASIC 'Product intervention: OTC binary options and CFDs' (Consultation Paper 322), August 2019, < https://asic.gov.au/regulatory-resources/find-a-document/consultation-papers/cp-322-product-intervention-otc-binary-options-and-cfds/>

[17] ASIC 'Product intervention: OTC binary options and CFDs' (Consultation Paper 322), August 2019, < https://asic.gov.au/regulatory-resources/find-a-document/consultation-papers/cp-322-product-intervention-otc-binary-options-and-cfds/>

[18] Financial data provided by members of the Australian CFD and FX Association.

[19] Figure provided by Pepperstone, estimated by industry size.

[20] Estimated employment figure of 1000 provided by Pepperstone.

3.2 Other CFD brokers

Although the requirement to hold an AFSL exists, unlicensed brokers operate throughout Australia. Despite best efforts to enforce compliance, ASIC was aware of at least 40 unlicensed brokers providing mostly binary options to retail clients in Australia as of 2016.[21] For example, in 2016, ASIC released a warning regarding Market City International who were falsely claiming to be a licensed broker of a number of products including CFDs.[22]

In 2017, ASIC investigated a further 330 unlicensed mobile apps that were offering similar products under misleading information to Australian clients.[23] Again, these apps mostly focussed on selling binary options.[24]

Further, there are no restrictions on clients trading though offshore brokers that are not subject to Australian regulations, making it difficult to determine the exact number of brokers selling CFD products to Australian clients. In the past, ASIC has issued warnings about retail clients engaging with particular offshore brokers, however, it is largely unable to take further action against them.[25]

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[21] Australian Securities and Investments Commission, *16-218MR ASIC crackdown on unlicensed retail OTC derivative providers*, 16 July 2016, <https://asic.gov.au/about-asic/news-centre/find-a-media-release/2016-releases/16-218mr-asic-crackdown-on-unlicensed-retail-otc-derivative-providers/>

[22] Australian Securities and Investments Commission , *16-066MR ASIC warns investors about dealing with Market City International and Brokers500*, 8 March 2016, <https://asic.gov.au/about-asic/news-centre/find-a-media-release/2016-releases/16-066mr-asic-warns-investors-about-dealing-with-market-city-international-and-brokers500/>

[23] Australian Securities and Investments Commission, *17-257MR ASIC targets unlicensed binary option mobile apps*, 1 August 2017, <https://asic.gov.au/about-asic/news-centre/find-a-media-release/2017-releases/17-257mr-asic-targets-unlicensed-binary-option-mobile-apps/>

[24] Ibid.

[25] Australian Securities and Investments Commission, *16-189MR ASIC warns investors about dealing with GOptions, Porterfinance, Boss Capital, MaxOptions, Bloombex Options, Citrades, RBoptions and OptionsXO*, 9 June 2016, < https://asic.gov.au/about-asic/news-centre/find-a-media-release/2016-releases/16-189mr-asic-warns-investors-about-dealing-with-goptions-porterfinance-boss-capital-maxoptions-bloombex-options-citrades-rboptions-and-optionsxo/>

4 Limits on leverage

Key points

- The theoretical literature expects interventions to be net positive although actual evidence is less definitive.
- Trading volumes have declined.
- Traders indicate a likely net decrease in size of trades.
- Traders indicate a likely net decrease in frequency of trades.
- Traders have left the European and UK markets although it is unclear if they have relocated, changed products or exited the market entirely.
- US experience points to reduced losses, but European experience suggests the effect on loss ratios has been small.

Similar interventions to those proposed in Australia have already been made throughout Asia, Europe and North America. This chapter presents relevant offshore experience in limiting leverage on trading volumes, patterns and behaviours.

This chapter explores what the impact of introducing leverage limits may be in Australia based on:

- international experience
- the survey of traders
- insights from interviews with traders.

4.1 What were the impacts of limits on leverage in offshore markets?

Regulated leverage limits gained traction after the Global Financial Crisis (GFC) as part of the global rethink of capital controls. Table 4.1 shows the leverage requirements for selected jurisdiction for CFDs for different underlying asset classes.

Table 4.1: CFD margin limits by jurisdiction

Jurisdiction	Major currency	Non-major currency	Commodities and indices	Individual equities	Other (incl. Crypto)
Europe*	30:1	20:1	10:1	5:1	2:1
United Kingdom	30:1	20:1	10:1	5:1	2:1
Singapore	20:1	20:1	20:1	10-5:1	5:1
Japan	25:1	25:1	50-5:1	50-5:1	50-5:1
Hong Kong	20:1	20:1	Prohibited	Prohibited	Prohibited
South Korea	10:1	10:1	Prohibited	Prohibited	Prohibited
Canada**	50:1	50:1	-	-	-
Dubai	50:1	20:1		10:1	
Australia (proposed)	20:1	20:1	15-10:1	5:1	2:1

Source: Australian Securities and Investments Commission, Consultation Paper 322. Pepperstone email from Dubai Financial Services Authority.

Note: This table is approximate as there are cross overs between some asset classes. *Europe refers to only European countries that have adopted ESMA restrictions. **Canada's requirements depend on the currency pair.

There are no CFD margin limits in Switzerland and New Zealand.[26]

4.1.2 Changes to regulations in offshore markets

4.1.2.1 North America

After the GFC, the United States conducted a variety of investigations to evaluate conduct in the markets for over the counter (OTC) products. These investigations culminated in the Dodd-Frank Act (2010) that provided a framework for regulating OTC derivatives.[27] As a consequence, the Commodity Futures Trading Commission (CFTC) and the National Futures Association (NFA) in the United States introduced leverage limits on rolling spot FX contracts of 50:1 on major currency pairs and 20:1 on all others.[28]

Following the lead of the United States, the Investment Industry Regulatory Organisation of Canada (IIROC) introduced leverage requirements. Canada banned binary options with a maturity of less than 30 days in September 2017.[29]

4.1.2.2 Asia

In 2010, Japan introduced leverage requirements on all currency pairs of 50:1. This was significant as Japan had the largest retail investor population in 2010 with 30% of all spot FX trades.[30] In August 2011, the leverage limits were revised to the current level of 25:1. Although ultimately choosing not to proceed, Japan briefly considered reducing the leverage limits to 10:1 in 2018 after significant losses were made across foreign exchange markets with the surprise devaluation of the Swiss Franc in 2015.[31]

In Hong Kong, CFDs and binary options are not currently offered to retail investors.[32] However, other forms of leveraged FX trading are commonplace and the Hong Kong Securities and Futures Commission (SFC) have enforced margin FX limits of 20:1 for all currency pairs.[33]

In South Korea, CFDs on products other than FX are prohibited and leverage ratio limits on FX have gone from 50:1 to 20:1 in 2009 and, more recently, 10:1 in 2011.[34]

In Singapore, more licensed firms offer CFDs and leveraged forex contracts to retail investors than binary options, which are currently limited to those that only reference debentures, stocks or shares.[35] The Monetary Authority of Singapore (MAS) applies the below leverage requirements:

- 20:1 for margin FX
- 20:1 for CFDs on indices
- 10:1-5:1 for CFDs on equities

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[26] Gareth Vaughan (2019) interst.co.nz <https://www.interest.co.nz/personal-finance/101490/asic-proposes-major-crackdown-peddling-high-risk-derivative-products-retail>
[27] Securities Exchange Commission, *Dodd-Frank: Derivatives*, 04 May 2015, <https://www.sec.gov/spotlight/dodd-frank/derivatives.shtml>
[28] Australian Securities and Investments Commission, *16-218MR ASIC crackdown on unlicensed retail OTC derivative providers*, 16 July 2016, <https://asic.gov.au/about-asic/news-centre/find-a-media-release/2016-releases/16-218mr-asic-crackdown-on-unlicensed-retail-otc-derivative-providers/>
[29] Ontario Securities Commission, *Canadian securities regulators announce ban on binary options,* 28 September 2017*,* <https://www.osc.gov.on.ca/en/NewsEvents_nr_20170928_canadian-regulators-announce-ban-on-binary-options.htm>
[30]Dagfinn Rime and Michael King, *The $4 trillion question: What explains FX growth since the 2007 survey*, VOX CEPR Policy Portal, <https://voxeu.org/article/4-trillion-question-what-explains-fx-growth>
[31] Ricardo Esteves, *Japan's potential leverage cap at 25:1 for institutional FX is a reminder of SNB crisis*, FinanceFeeds.com, <https://financefeeds.com/japans-potential-leverage-cap-at-251-for-institutional-fx-is-a-reminder-of-snb-crisis/>
[32] International Organization of Securities Commissions, *Report on the IOSCO survey on Retail OTC leveraged products*, December 2016, <https://www.iosco.org/library/pubdocs/pdf/IOSCOPD550.pdf>
[33] Australian Securities and Investments Commission, *16-218MR ASIC crackdown on unlicensed retail OTC derivative providers*, 16 July 2016, <https://asic.gov.au/about-asic/news-centre/find-a-media-release/2016-releases/16-218mr-asic-crackdown-on-unlicensed-retail-otc-derivative-providers/>
[34] Ibid.
[35] International Organization of Securities Commissions, *Report on the IOSCO survey on Retail OTC leveraged products*, December 2016, <https://www.iosco.org/library/pubdocs/pdf/IOSCOPD550.pdf>

- 5:1 over other reference instruments.[36]

4.1.2.3 Europe and the United Kingdom

Intervention in the United Kingdom and Europe present more comparable case studies in terms of the extent of the restrictions.

In August 2018 the European Securities and Markets Authority (ESMA) introduced restrictions on the marketing, distribution or sale of CFDs to retail clients. A range of restrictions were imposed, in particular, leverage limits on the opening of a position by a retail client were imposed which range from 30:1 to 2:1 according to the volatility of the underlying asset price.

In the United Kingdom, the FCA followed ESMA's lead and adopted the same leverage restrictions in August 2018. In April 2019, the UK announced that these measures would be permanent. These restrictions included:

- limiting leverage ratios to between 30:1 and 2:1 depending on the volatility of the underlying asset
- closing out a customer's position when their funds fall to 50% of the margin needed to maintain their open positions
- negative balance restrictions – a customer cannot lose more than the total funds in their trading account
- stop offering customers inducements to trade
- providing a standardised risk warning[37]
- a permanent ban on sale, marketing and distribution of binary options.[38]

Although the FCA adopted the majority of the European measures, the UK made two amendments:

- applying limits to a broader range of securities (turbo certificates, knock out options and delta one options)
- leverage limits on government bonds are 30:1 compared to 5:1 under ESMA.[39]

Most national regulators around Europe have decided to impose ESMA leverage restrictions on a permanent basis therefore not requiring ESMA to renew these restrictions[40].

On the other hand, Poland has proposed to ESMA to allow certain qualified retail clients to trade forex with a higher level of leverage of 100:1.[41] The Polish financial regulator, the Komisja Nadzoru Finansowego (KNF), proposed this policy due to the significant capital required to be classified as a professional trader under ESMA rules. The KNF analysis states that the €500,000 assets requirement is prohibitively high for the country's residents.[42] Moreover, the Polish regulator states that when looking at available data, many customers moved their accounts to offshore jurisdictions to access higher-leverage trading.

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[36] Australian Securities and Investments Commission, *16-218MR ASIC crackdown on unlicensed retail OTC derivative providers*, 16 July 2016, <https://asic.gov.au/about-asic/news-centre/find-a-media-release/2016-releases/16-218mr-asic-crackdown-on-unlicensed-retail-otc-derivative-providers/>

[37] Financial Conduct Authority, *Consultation Paper CP18/38: Restricting contract for difference products sold to retail clients and a discussion of other retail derivative products*, December 2018 <https://www.fca.org.uk/publication/consultation/cp18-38.pdf>

[38] Ibid.

[39] Ibid.

[40] European Securities and Markets Authority, *ESMA ceases renewal of product intervention measures relating to contracts for differences*, 30 July 2019, <https://www.esma.europa.eu/press-news/esma-news/esma-ceases-renewal-product-intervention-measures-relating-contracts>

[41] Komisja Nadzoru Finansowego, *Communication from the KNF Board on the introduction of additional requirements for offering contracts for differences (CFDs) to retail clients, 1 August 2019, <https://www.knf.gov.pl/en/news?articleId=66719&p_id=19>*

[42] European Securities and Markets Authority, *Opinion of the European Securities and Markets Authority on the product intervention measures relating to contracts for differences proposed by the Komisja Nadzoru Finansowego of Poland*, 30 July 2019, < https://www.esma.europa.eu/sites/default/files/library/esma-35-43-1995-_esma_opinion_under_article_432_mifir_pl_cfd.pdf>

4.1.3 Impacts on trading behaviour

A consistent occurrence across jurisdictions has been a reduction in trading volumes and consolidation of trading businesses or brokerages under increased leverage requirements.

Heimer and Simsek (2019) conducted a review of the 2010 leverage caps introduced in US retail foreign exchange market. They found that traders who were subject to the constraints reduced their trading volume by 23% relative to those who were not, however, their trading patterns and behaviours remained largely unchanged.[43] Participants more likely to leave the market are those who rely on leverage to make considerable trades with small initial investments. As for professional traders, the rate at which they receive margin calls increased but industry insiders do not expect this to change their trading patterns.[44]

Volumes may decline due to some participants choosing to exit the market or simply because each trader can now place fewer trades with the same amount of capital. Discerning these two effects is a challenge, although there is evidence to suggest that both are occurring.[45] The FCA expect trading volumes in United Kingdom to decline by 28% as a result of the introduction of leverage requirements, although this effect is being compounded by declining market conditions as a result of Brexit among other things.[46] In terms of client numbers, active retail clients have declined by 72,783 since the announcement of the planned intervention in the United Kingdom.[47]

The changes in trading behaviour that were observed in Europe and the United Kingdom were not mirrored in Japan. The available data indicates that the total number of accounts has consistently increased, while active accounts has remained steady.[48]

According to monthly trading data for OTC margin FX, after the margin requirements were permanently introduced in March 2016, volumes did decline. Levels appear to have recovered by 2017, although the available data do not distinguish between retail and wholesale clients.[49]

Japan, however, may not be reflective of other markets due to the high prevalence of carry trading in the market for margin FX. Carry trading refers to the practice of borrowing in a low-interest environment and investing in a high-interest environment and is common practice in Japan's low interest-rate environment.[50]

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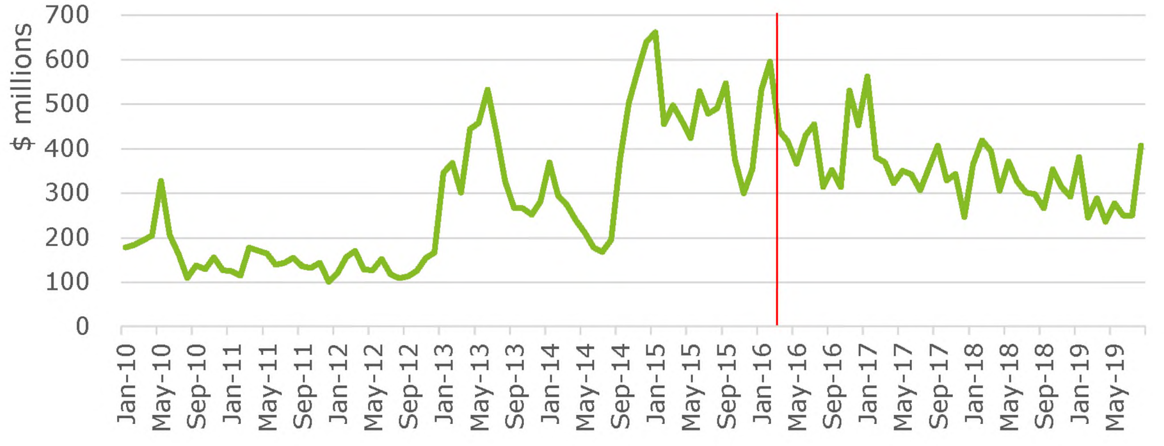
[43] Rawley Heimer and Alp Simsek, *Should retail investors leverage be limited?*, Journal of Financial Economics, Vol 132, 2019.
[44] Justin Paolini, *How to trade around the new ESMA rules* (26 May 2018), FXRenew, <https://fxrenew.com/forex-blog/how-to-trade-around-the-new-esma-rules/>
[45] Financial Conduct Authority, *Consultation Paper CP18/38: Restricting contract for difference products sold to retail clients and a discussion of other retail derivative products*, December 2018 <https://www.fca.org.uk/publication/consultation/cp18-38.pdf>
[46] Ibid.
[47] Ibid.
[48] Tomohiro Niimi, *Recent trends in foreign exchange (FX) margin trading in Japan*, Bank of Japan, August 2016, <https://www.boj.or.jp/en/research/wps_rev/rev_2016/data/rev16e05.pdf>
[49] The Financial Futures Association of Japan, *Monthly statistical bulletin for over-the-counter retail margin FX trading*, August 2019, <https://www.ffaj.or.jp/library/performance/fx_flash/>
[50] Masaki Kondo, *Japan's margin traders: why they matter for currency markets*, 12 February 2019, <https://www.bloomberg.com/news/articles/2019-02-12/japan-s-margin-traders-why-they-matter-for-currency-markets>

Chart 4.1: Trading volume for Japanese OTC retail Margin FX trading.



Source: Monthly Statistical Bulletin on Over-The-Counter Retail FX Margin trading, FFAJ

4.1.4 Outcomes for traders

Leverage caps reduce volumes, however, there appears to be less evidence on the effects on *outcomes* for traders, e.g. loss ratios.

Heimer and Simsek found that US retail clients had 40% lower trading losses than clients without leverage restrictions. The authors also sought to test the theory that reduced market liquidity would widen margins for derivate products. Their simulation presented results contrary to this hypothesis by finding that although margin requirements lowered liquidity in the market, they found no significant evidence of widening spreads.[51]

Regulators have also been interested in reviewing the impact of the restriction on traders. One of the major areas of concern for both ASIC and international jurisdictions has been the proportion of clients losing money on these products. Unlike the academic review of US leverage restrictions, results from Europe present weaker evidence of improved outcomes. According to XTB, a brokerage house in Poland, European regulation has had a minimal effect on client losses with only a 3% reduction in the number of clients making a net loss (77% continued to make a loss after the intervention). Moreover, ESMA found that after the first month of implementation the share of profitable retail client accounts decreased compared to the same month a year prior.[52]

In South Korea, higher leverage ratios have not dramatically impacted losses on trades. According to the Financial Supervisory Service (FSS), margin FX trading volumes have declined over time but losses still remain high.[53]

In the UK, there is qualified evidence that the restrictions have had a positive impact, by reducing client losses. The FCA announced that since restrictions were announced, total losses for retail clients were reduced by £77.3mn over the period of August to October 2018.[54] This statistic should be viewed with caution, however, as the FCA does not report the proportion of clients still making a loss. As noted above, the amount of active retail clients decreased by 72,783 (approximately 26%) over the same period and it is possible that the reduction in total losses is due to a

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[51] Rawley Heimer and Alp Simsek, *Should retail investors leverage be limited?*, Journal of Financial Economics, Vol 132, 2019.
[52] Miroslaw Wilk, *KNF's decision on CFDs in Poland explored -1:100 leverage, experienced client, training* (9 August 2019), Comparic.com <https://comparic.com/update-knfs-decision-cfds-poland-leverage-experienced-client-training/>
[53] International Organization of Securities Commissions, *Report on the IOSCO survey on Retail OTC leveraged products*, December 2016, <https://www.iosco.org/library/pubdocs/pdf/IOSCOPD550.pdf>
[54] Financial Conduct Authority, *Consultation Paper CP18/38: Restricting contract for difference products sold to retail clients and a discussion of other retail derivative products*, December 2018 <https://www.fca.org.uk/publication/consultation/cp18-38.pdf>

contraction in the overall market, rather than lower loss ratios.[55] Furthermore, the FCA acknowledges that there is no guarantee that the proportion of clients making a loss will improve and that some trades are likely to be less profitable after the leverage limits.[56]

4.1.5 Impact on brokers

Overseas, reductions in the number of active clients, combined with smaller trades on average, have meant that the market is no longer supportive of the number of brokerage businesses in existence. This is due to the decline in volumes eating into the intermediation revenues of brokerages. For example, since the CFTC restrictions on FOREX were introduced in the United States, only 4 of the 25 brokerages have survived.[57]

In Europe, the impact of tighter regulations has been costly for brokerage businesses. For example, the value of client trades for CMC Markets, one of the leading global brokers, decreased by £328 billion pounds (13%) due to lower volumes. This led to a decline in operating income of 30% since the introduction of ESMA regulations.[58]

4.2 What are the likely impacts of limits on leverage in Australia?

Australian-based CFD traders were asked how they would respond to limits on leverage being imposed. This was conducted through with an industry survey of 2,139 participants and interviews with 18 traders.

Chart 4.2 shows that 64% of survey participants indicated that they would change to a broker that offered higher leverage if these restrictions were to come into place. Only 10% of participants indicated that they would not alter their trading patterns or broker choice and 9% suggested they would stop trading. If traders do move their trading to brokers based offshore that offer higher leverage, trading activity in the local market would contract. A contraction in trading activity is expected to decrease the number of brokers and people employed by the industry in Australia.

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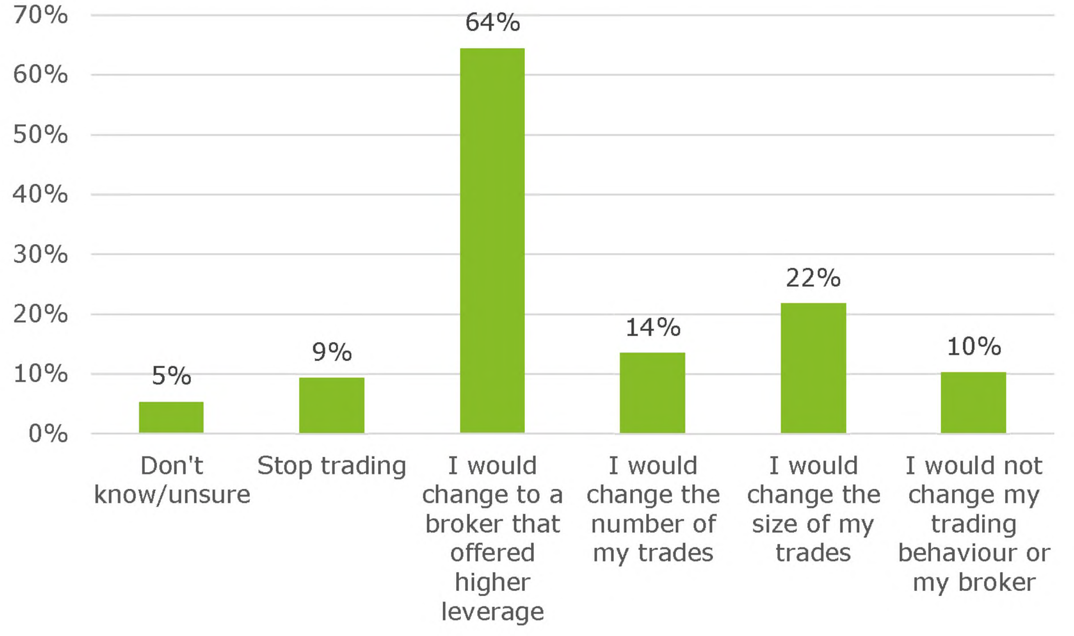
[55] Ibid. Percentage calculated on 279,000 retail account trading monthly in 2017.
[56] Financial Conduct Authority, *Policy Statement PS19/18: Restricting contract for difference products sold to retail clients*, July 2019 < https://www.fca.org.uk/publication/policy/ps19-18.pdf>
[57] Rawley Heimer and Alp Simsek, *Should retail investors leverage be limited?*, Journal of Financial Economics, Vol 132, 2019.
[58] CMC Markets, *Final results for the year ending 31 March 2019,* 6 June 2019, <https://assets.cmcmarkets.com/group/pdf/cmc-markets-plc-fy19-full-year-results.pdf>

4.2.1 Impacts on trading behaviour

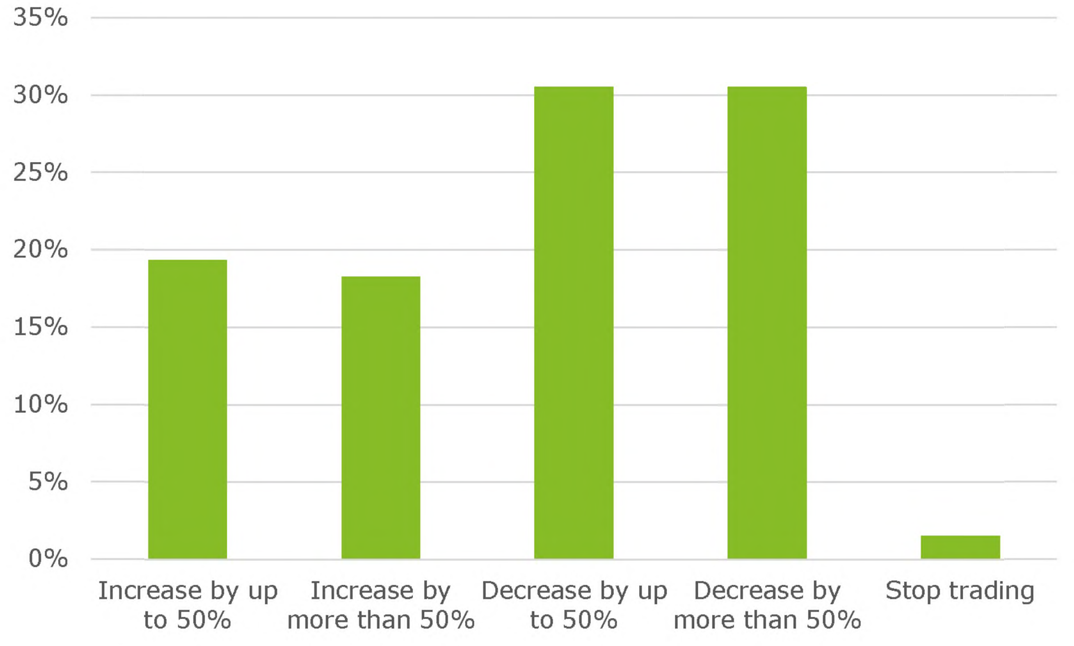
Chart 4.2: CFD traders expected response to the proposed limits on leverage



Source: Deloitte Access Economics and DTermine, CFD Survey 2019 (2019).
Note: Survey respondents were given a description of the proposed ASIC leverage limits and asked "If these caps are implemented, what would you do". They were allowed to tick as many of the following options "I would not change my trading behaviour or my broker", "I would change the size of my trades", "I would change the number of my trades", "I would change to a broker that offered higher leverage", "Stop trading" and "Don't know/unsure". Sample = 2,139 respondents. See Appendix A for further detail.

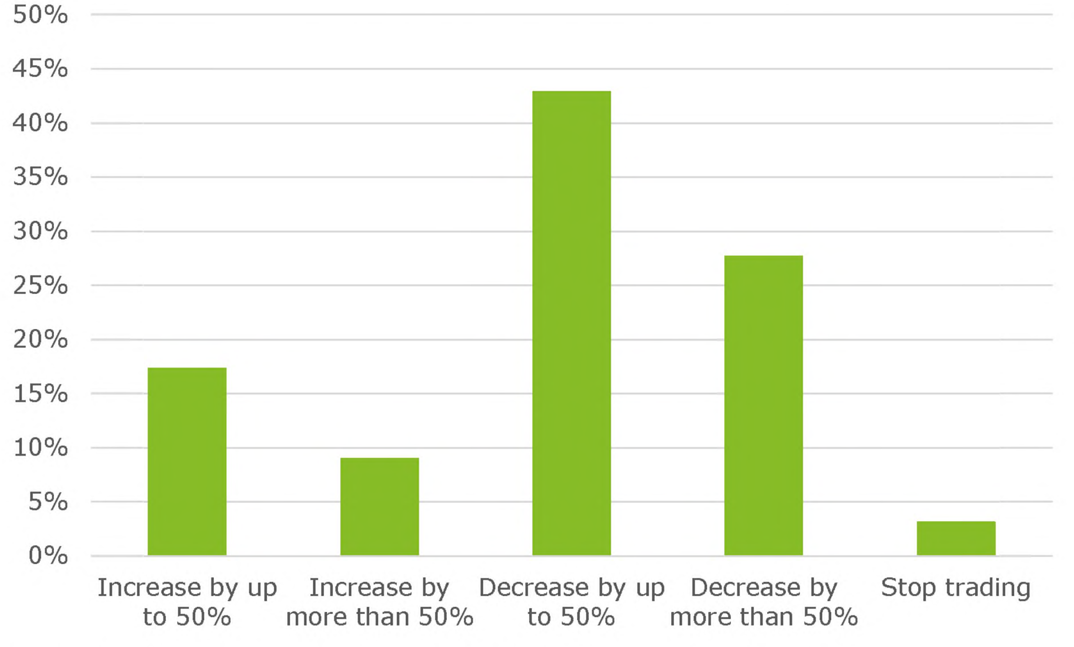
Chart 4.3 and Chart 4.4 show mixed results with traders indicating both an increase and decrease in the size and frequency of trades. Some 61% of traders suggest that their trade size will decrease and 37% suggested the size of their trades will increase. Similarly, 71% of traders indicate that the frequency of trades will decline whereas 16% said frequency will increase. This is likely to demonstrate the different levels of capital available to retail traders. Traders with sufficient capital will be able to increase the size and frequency of their trades to accommodate the reduced leverage. Clients without the required capital, however, will not be able to execute the same volumes as previously. Ultimately, however, both charts indicate a net decrease in size and volume.

Chart 4.3: Expected impact of leverage caps on size of trades



Source: Deloitte Access Economics and DTermine, CFD Survey 2019 (2019).
Note: Survey respondents, who had responded that they would change the size of their trades if ASIC's proposed leverage limits were implemented, were asked "If these caps are implemented, how would you change the size of your trades?". There were five options; "Increase by up to 50%", "Increase by more than 50%", "Decrease by up to 50%", "Decrease by more than 50%", and "Stop trading". Sample = 466 responses.

Chart 4.4: Expected impact of leverage caps on the frequency of trading



Source: Deloitte Access Economics and DTermine, CFD Survey 2019 (2019).
Note: Survey respondents, who had responded that they would change the frequency of their trades if ASIC's proposed leverage limits were implemented, were asked "If these caps are implemented, how would you change the frequency of your trades?". There were five options; "Increase by up to 50%", "Increase by more than 50%", "Decrease by up to 50%", "Decrease by more than 50%", and "Stop trading". Sample = 289 responses.

> *I will try to trade the same way as I always have, it's just riskier. I will have to put more money in margins.*
>
> *(James Chen, CFD trader)*

Industry consultation yielded a variety of responses from complete opposition to leverage caps, to indifference or ignorance. Due to the different client types, the outcomes for traders are likely to vary by purpose, experience and capital. Notwithstanding this, the majority of participants noted that these measures would adversely affect them in some way.

Leverage limits were by far the greatest concern for traders among the proposed intervention measures. The reason these clients were concerned was because it would reduce the volume with which they can trade, and hence the potential profits they can earn.

> *This will definitely affect me. I do not have the margins to trade and it will most likely cost me my business. I will definitely be moving offshore, probably Switzerland, although I'm yet to properly look into it.*
>
> *(Morne Van der Walt, CFD trader)*
>
> *I currently use 500:1 and could maybe get by with 300:1. Anything less than that and I'd have to move offshore.*
>
> *(Michael D., CFD trader)*

Some of the objections to leverage restrictions came from the presumption that using leverage meant that the traders did not have the required funds. These traders often stated that they operated under self-imposed limits on their total funds available.

Through the consultations it was evident that clients are apprehensive about moving to an offshore broker, however, for some it may become a necessity. Many believed that the leverage restrictions would only exacerbate the losses by forcing clients offshore.

> *If they take away people's leverage they will just move to different products such as futures, options and warrants. For these products, potential losses are considerably higher.*
>
> *(Tim Klingner, CFD trader)*
>
> *I think what ASIC is trying to do is good, although it won't work. I will certainly consider switching to an offshore broker and this is where the real danger is. So many of my friends have been stung by offshore brokers.*
>
> *(Anonymous CFD trader)*
>
> *I travel up to eight months a year and because of that I have shopped around overseas. I used to have an account in Switzerland - It's very easy to set up.*
>
> *(John Francis Kelly, CFD trader)*

Not all respondents interviewed were concerned by the intervention on leverage requirements. These clients rarely leveraged positions above the proposed limits and will remain unaffected. For these traders, leverage was not sole reason for trading CFDs. The platforms and resources available through brokers makes it simple for them to trade and they found the product itself is easier to understand than other leveraged OTC products.

EA traders would be impacted in the same way by ASIC's proposed measures as manual traders. Leverage restrictions and margin cut-offs would interfere with the trading algorithm and, depending on the settings, would require recalibration. This process was not a major concern for all EA traders; it appears that EAs can be simple and cheap to reprogram. However, EA traders consider it costly to take leverage away from a tool that they find to be working effectively.

It would not be difficult to recalibrate; I mess around with its settings all the time. It would just be a missed opportunity for me.

(Herve Nayna, CFD trader)

Whilst in the minority, some traders expressed support for ASIC's measures. If not outright support, they could at least see the sense in implementing protections on retail clients. A few of these traders were hoping to meet the criteria of a wholesale trader, and would therefore be unaffected.

In a way lower leverage ratios would be relief because it would mean I'd have to stop or reduce my trading activity.

(John Francis Kelly, CFD trader)

I'm in support of retail traders having leverage restrictions. As long as they don't start screwing with the actual traders in the market.

(Chris Cowell, CFD trader)

Others saw it as a missed opportunity to more carefully consider the wider implications and present a more sophisticated approach to those seen in Europe.

This could have been an opportunity for Australia to take a different approach to the rest of the world and be a leader in a more sophisticated legislation. Instead ASIC have followed the herd.

(Anonymous, CFD trader)

Far more common was frustration that these measures were an overstep on liberties and misdirected compared to legislation surrounding other activities, e.g. gambling. Interviewees often suggested that people needed to take greater personal responsibility for educating themselves and brokers should also be more accountable for ensuring people have access to information to learn and develop their strategies.

I don't understand how I can be allowed to go down to Flemington Racecourse and bet away all my money if I choose to but they're going to stop me from trading CFDs for my own protection.

(Tim Highett, CFD trader)

I would have liked to see the industry get some qualifications. This could take the form of a simple course but there should be stricter accountability for people to be educated. We should put this responsibility back onto the broker.

(Anonymous CFD trader)

The majority of traders were against blanket restrictions as they have devoted considerable time, effort and money to educate themselves.

I have been full-time trading for 4 years but I do not have the capital needed to make a decent living if these higher margin requirements come in. These limits will force me to return to work and I have a big hole in my CV.

(Anonymous, CFD trader)

As well as clients moving to exploit higher leverage in other jurisdictions, some brokerage firms are likely to relocate offshore.

I have seen some brokers advertising that they are now registered in the Seychelles.

(Samuel Christensen, CFD trader)

If there are fewer participants in the market as domestic and international clients seek more lenient leverage requirements offshore, the proposed changes to leverage requirements also would be expected to reduce the tax contribution of CFD brokers.

5 Margin close-out

Key points

- Evidence from offshore is limited, although European sources report a reduction in instances of negative equity.
- Most traders support negative balance protection.
- Many traders support some level of margin close-out protection.
- Brokers may already offer one or both of the proposed measures.
- Higher protection (margin close-out) for inexperienced traders is supported.
- EA traders were more likely to express concern with margin closeouts than negative balance restrictions.

5.1 What were the impacts of margin close-outs in offshore markets?

The impact of margin close-outs is more difficult to assess than leverage requirements due to fewer examples of this in practice. Nonetheless, the below section considers evidence emerging from the United Kingdom and Europe.

5.1.1 Impact on trading behaviours

The impact of margin close-outs and negative balance restrictions on trading behaviour is less obvious than leverage restrictions. Margin requirements are put in place to discourage more vulnerable traders who are less likely to be able to afford the downside risk, and also to prevent investors from chasing losses.[59] In this sense, the impact on trading behaviour is expected to be a decline in the number of retail clients, particularly those with limited capital and at most risk of encountering financial distress.

The unintended consequence of this restriction is that it drives more than just the most vulnerable retail clients away from the market. Having margin close out and negative balance restrictions forces clients to hold higher margin accounts in order to avoid positions closing out based on minor market movements. This additional margin requirement ties up capital that can otherwise be deployed by investors in other areas and increases the effective execution cost of each trade.

Increasing the margin levels also increases the client's counterparty risk. As recently as 2015, counterparty risk came to the forefront of traders' minds as several high profile brokers faced insolvency in the wake of the surprise decision to de-peg the Swiss franc. With the decision to de-peg, the franc surged 40% against the Euro wiping off tens of millions of dollars across FOREX markets.[60] Several large FOREX brokers including the UK's Alpari Limited filed for insolvency and others including FXCM and London Capital Group Holdings sustained significant losses.[61]

5.1.2 Outcomes for traders

The FCA has stated that it expects the outcome for traders to be a decrease in their overall losses.[62] Whilst it does not change the underlying risk of the trade, it does limit the amount of

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[59] Financial Conduct Authority, *Consultation Paper CP18/38: Restricting contract for difference products sold to retail clients and a discussion of other retail derivative products*, December 2018 <https://www.fca.org.uk/publication/consultation/cp18-38.pdf>

[60] Anirban Nag and Steve Slater, *Swiss franc shock shuts some FX brokers; regulators move in*, Reuters, 16 January 2015, <https://www.reuters.com/article/us-swiss-snb-brokers/swiss-franc-shock-shuts-some-fx-brokers-regulators-move-in-idUSKBN0KP1EH20150116>

[61] Ibid.

[62] Financial Conduct Authority, *Consultation Paper CP18/38: Restricting contract for difference products sold to retail clients and a discussion of other retail derivative products*, December 2018 <https://www.fca.org.uk/publication/consultation/cp18-38.pdf>

their margin account that can be lost before intervention occurs. This further protects clients from sudden changes in their position.

The margin close-out and negative balance limits seem to have a net positive impact on clients and are generally supported by brokerages too. According to ESMA, the intervention reduced the number of automatic margin close outs for retail clients by 99.5% between August and October 2017 and 2018. Furthermore, between August and October 2018, firms forgave debts totalling £1.45 million due to negative balance protections.[63] This is expected to save clients £5.8 million annually.

Although brokers generally supported these measures, they did note that it would come at a cost to them. Besides any potential loss of volume and clients, these measures placed additional requirements on monitoring systems. IG Markets estimated this functionality upgrade would cost £3.5 million.[64] Brokers also expressed the potential for clients to game the system from negative balance protection. By opening an inverse trade on a separate account, clients have a limit on losses but not on the potential upside. To ensure that this is not exploited, brokerages will need to boost oversight and monitor positions more carefully, although the FCA acknowledges that this risk cannot be entirely mitigated.[65]

5.2 What are the likely impacts of negative balance protection and margin close-outs in Australia?

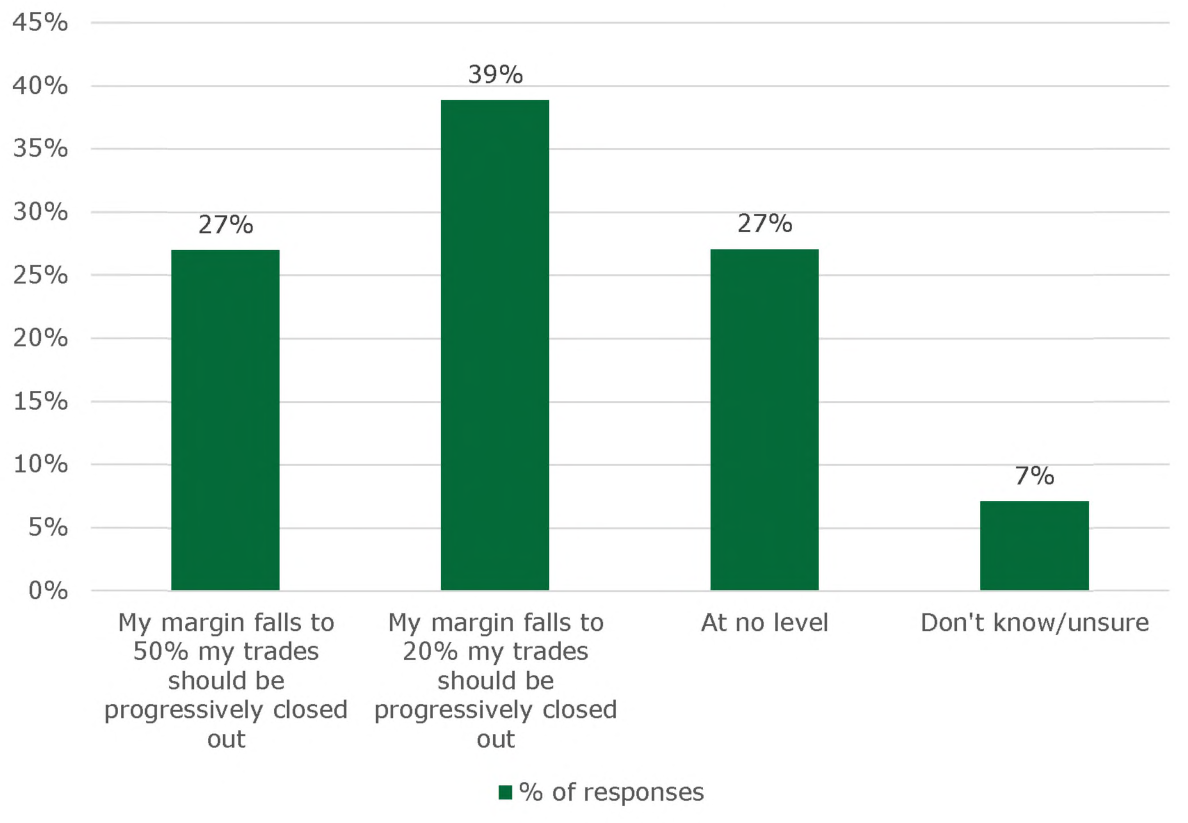
In order to assess how these restrictions might impact the volumes and behaviours of clients, Australian-based CFD traders were asked their views on negative balance protection and margin close outs being imposed.

5.2.1 Impact on trading behaviours

Chart 5.1 supports the international evidence that generally traders are supportive of these restrictions being enforced at some margin level. Only 27% of respondents did not agree with any level of margin restriction. The largest group, however, suggest that the proposed limit of 50% is too high with 39% of respondents.

[63] Financial Conduct Authority, *Consultation Paper CP18/38: Restricting contract for difference products sold to retail clients and a discussion of other retail derivative products*, December 2018 <https://www.fca.org.uk/publication/consultation/cp18-38.pdf>
[64] European Securities and Markets Authority, *Product intervention analysis: Measures on contracts for differences*, 1 June 2018,
[65] Financial Conduct Authority, *Consultation Paper CP18/38: Restricting contract for difference products sold to retail clients and a discussion of other retail derivative products*, December 2018 <https://www.fca.org.uk/publication/consultation/cp18-38.pdf>

Chart 5.1: Retail clients' preferred margin close-out protection levels with negative balance protection



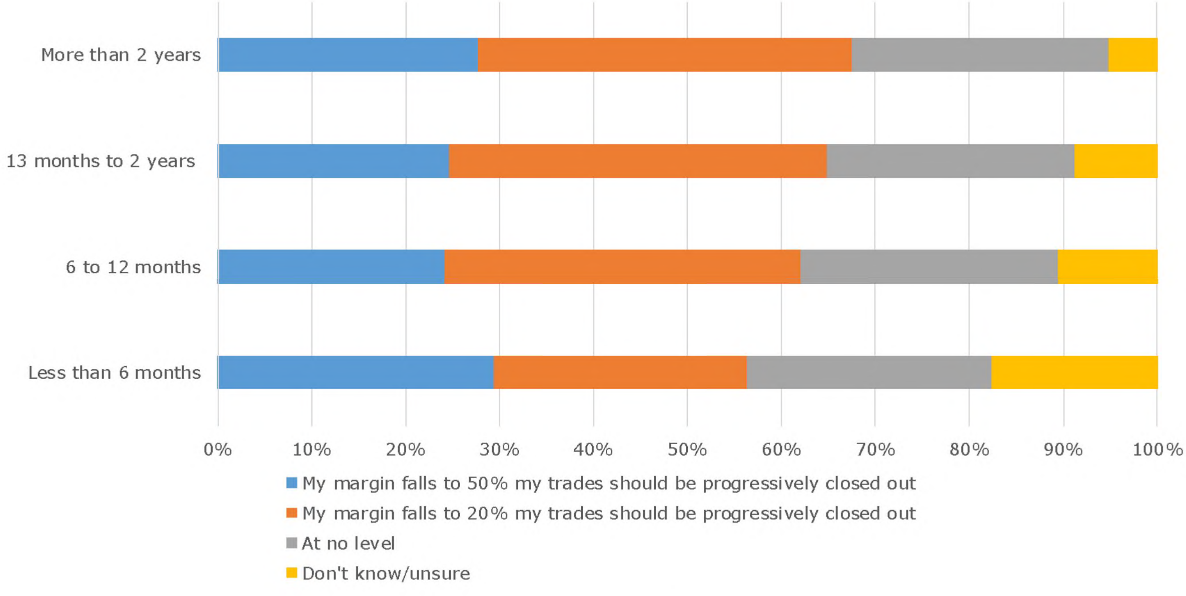
Source: Deloitte Access Economics and DTermine, CFD Survey 2019 (2019).
Note: Survey respondents were given a description of the proposed ASIC negative balance and margin close-out protection measures and asked "If ASIC introduces negative balance protection, at what level, if any, do you think that margin close-out protection for retail clients should apply?". There were four options "My margin falls to 50% my trades should be progressively closed out", "My margin falls to 20% my trades should be progressively closed out", "At no level" and "Don't know/unsure". Sample = 2,139 responses. See Appendix A for further detail.

In consultations, some traders saw mandatory close-outs as a sensible idea and did not believe that they would affect their trading or strategy. A number of these traders stated that these restrictions were already in place through their brokers.

> *My broker already has a 50% close out in place for me.*
>
> *(Anonymous CFD trader)*
>
> *I think this is a great idea, although these tools already exist. People just need to be more aware of them.*
>
> *(Samuel Christensen, CFD trader)*

As expected, support for these margin limits is related to the level of experience. Chart 5.2 shows that 29% investors in their first six months of trading believe a close-out limit of 50% is appropriate. By the time investors have two or more years experience, 40% agree that a lower 20% limit is appropriate.

Chart 5.2: Retail clients' preferred margin close-out protection levels with negative balance protection, by experience



Source: Deloitte Access Economics and DTermine, CFD Survey 2019 (2019).
Note: Survey respondents were asked "If ASIC introduces negative balance protection, at what level, if any, do you think that margin close-out protection for retail clients should apply?" and "How long have you been trading CFDs?", with options as described above in Chart 2.1 and Chart 5.1. Sample = 2139 responses. See Appendix A for further detail.

5.2.2 Outcomes for traders

Compared to the proposed margin requirements, the close-out and negative balance conditions received less opposition during consultations with retail traders.

> *I think the 50% close out rule is sensible. What is the point of having a margin if you're not going to close out against it?*
>
> *(Herve Nayna, CFD trader)*

However a number of clients did suggest that these restrictions, together with leverage requirements, would greatly affect their strategies. Mandatory close-outs force traders to realise losses more frequently and provides less ability to 'ride out' downturns.

> *For my particular strategy I need to be able to have a negative balance. Although my positions are always hedged, if something occurs suddenly I may go negative for a short period of time until I can get the right buy/sell in the other direction.*
>
> *(Michael D., CFD trader)*

Opposition towards mandatory closeouts and negative balance restrictions was more pronounced among EA traders. A number of EA traders stated their algorithms would not be compatible with a 50% margin close out rule.

> *The system allows my leverage and position to expand and contract but I trust my tool to always come out on top over time. These measures will force me to realise my losses more often instead of riding them out.*
>
> *(Anonymous CFD trader)*

One interviewee did not see that increasing their margins would be beneficial, only unnecessarily increase their counterparty risk.

> *I always have an account balance much larger than my exposure so that a volatility spike doesn't close out my position.*
>
> *(John Francis Kelly, CFD trader)*

6 Market data analysis

Key points

- Traders move to markets with higher leverage.
- A higher stop out limits both losses and profits.
- Full-day trading records required to evaluate the impact of leverage caps were not available.

Different groups of traders will be affected by the proposed changes according to their trading characteristics. This chapter explores the potential size of the affected groups, based on de-identified trading account data provided by Pepperstone.

6.1 How do leverage caps affect market participants?

The analysis performed was limited to the end-of-day trading positions that was provided by members of the association within the timeframe allowed for the consultations. It was observed during the analysis that the full-day trading records would be required for a more appropriate and robust analysis. However, members of the Association were unable to provide this data within the timelines available.

Analysis of broker data on the actual leverage utilised by clients on their positions, across different asset types, is required to clarify the potential impacts of the proposed leverage caps on the Australian market.

With this information, stakeholders would be better placed to gauge potential impacts, for example:

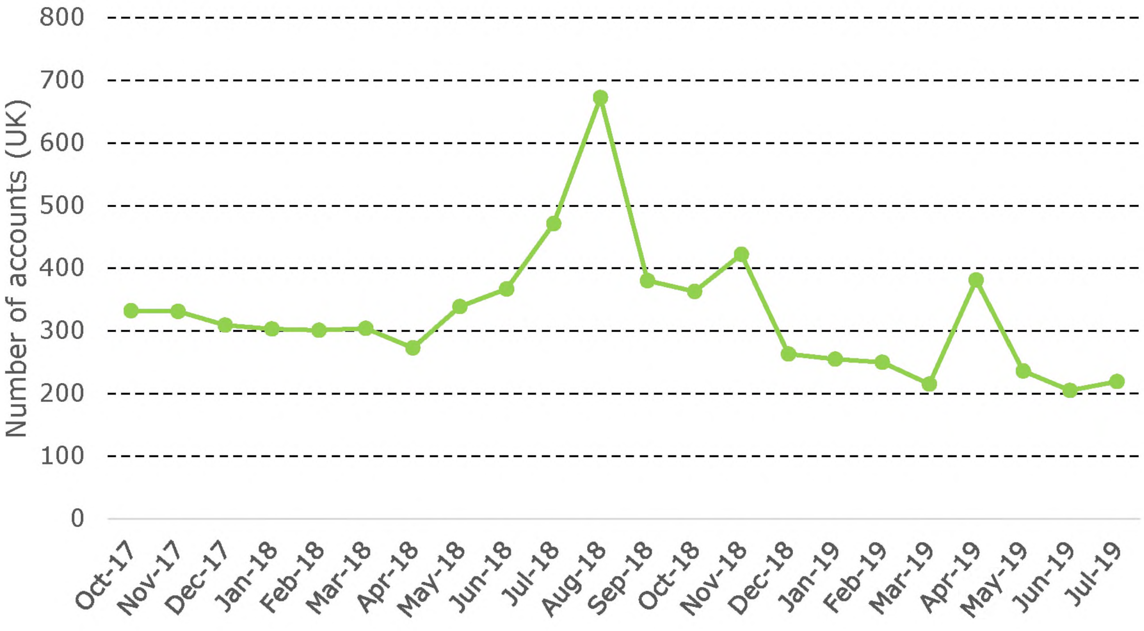
- the change to trader losses and loss ratios
- the number and type of traders that may stop trading CFDs or move their trading to brokers not licensed by ASIC
- how far liquidity (trading volumes) for different asset types may fall.

6.2 Do leverage caps result in traders changing brokers/markets?

In August 2018 the UK implemented similar leverage cap rules as those under consideration in Australia. There is a question as to whether customers, in response to the regulations, would open similar facilities in other jurisdictions where the leverage caps would not apply.

The UK data shows a marked increase in the number of accounts closing in August 2018.

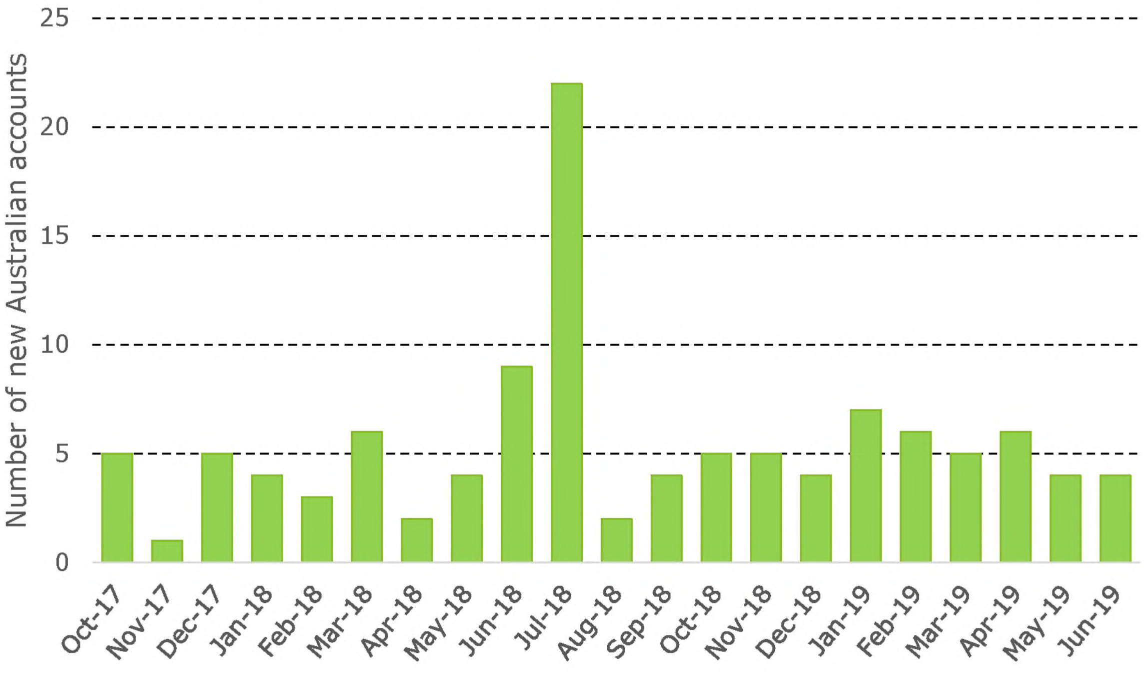
Chart 6.1: Number of trading accounts in United Kingdom



Source: Pepperstone trading data, Deloitte analysis.

Similarly, for where they could be identified, more former UK customers who opened an Australian account generally stopped using their UK account when the new leverage cap rules were implemented.

Chart 6.2: Number of new trading accounts in Australia



Source: Pepperstone trading data, Deloitte analysis.

This supports the hypotheses that introducing leverage cap rules in the UK drove customers to other jurisdictions where the leverage rules did not apply.

6.3 Does a fixed margin close out affect loss ratios?

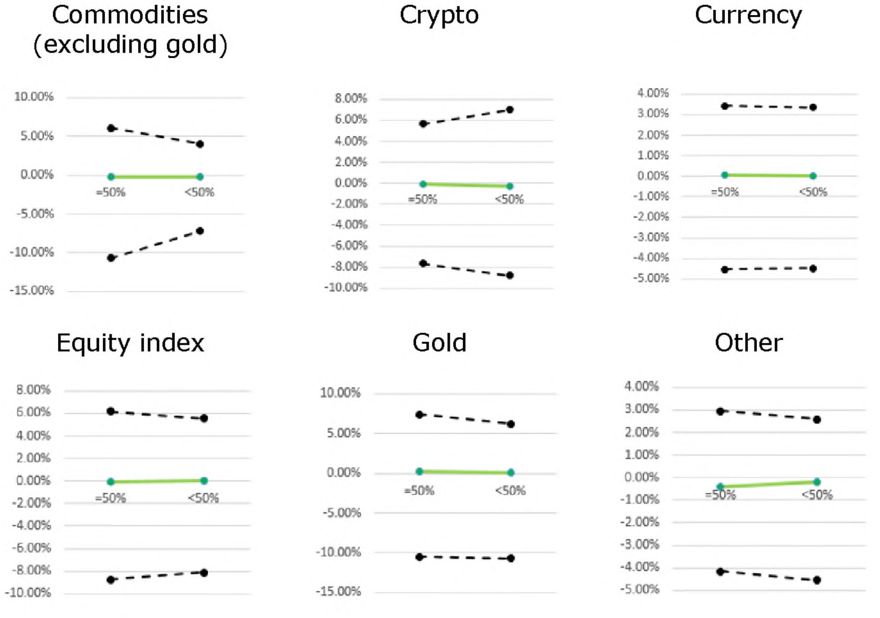
Currently, brokers institute a stop out percentage ranging from 10% to 50% for clients, depending on experience and asset class traded. Similar to the imposition of leverage caps, a higher stop out percentage limits both the profits and the losses of accounts compared to those accounts that have lower percentages.

Table 6.1: Daily gross profit as a percentage of equity by stopout percentage

	25th percentile		Median		75th percentile	
Stopout percentage	*50%*	*<50%*	*50%*	*<50%*	*50%*	*<50%*
Commodity excluding gold	-10.68%	-7.24%	-0.25%	-0.15%	6.09%	4.02%
Crypto	-7.63%	-8.79%	-0.06%	-0.23%	5.66%	7.03%
Currency	-4.52%	-4.48%	0.07%	0.03%	3.344%	3.35%
Equity index	-8.75%	-8.11%	-0.05%	0.07%	6.16%	5.55%
Gold	-10.50%	-10.71%	0.24%	0.03%	7.41%	6.23%
Other	-4.17%	-4.45%	-0.38%	-0.19%	2.95%	2.58%

Source: Pepperstone trading data, Deloitte analysis.

Chart 6.3: Daily gross profit as a percentage of equity by stopout percentage



Source: Pepperstone trading data, Deloitte analysis.

7 Conclusions

The Association does not question the need to protect unsophisticated retail investors. This is consistent with the views expressed by survey respondents and in interview with traders. Rather brokers argue that the measures proposed by ASIC do not consider the spectrum of retail clients and that a blanket approach will unnecessarily restrict the activities of experienced, informed investors.

The information gathered for this report indicates that there are different cohorts of traders, including groups that have more experience and greater capacity to absorb losses. Few traders used leverage below ASIC's proposed limits. More experienced traders have a preference for higher levels of leverage. Expert Adviser (EA) tools tended to be used by more experienced traders, but much trading is manual. However, the key findings are not representative of the entire market, because the analysis excludes unlicensed brokers, brokers offering binary options and retail clients based overseas who trade in the Australian market.

International evidence reviewed suggests that restrictions do affect trading behaviour, including reducing trading volumes and market participation. Margin requirements appear to reduce liquidity but not widen spreads.

The impact on traders losses is less clear, for example, the findings in the US not being replicated in Poland. The evidence is less clear about reduced losses; i.e. are individuals losing less because they are investing less, or are they losing a smaller share of the amount they invest.

The information suggests that for Australian-based market participants, brokers are likely to have a reduced client base, with fewer brokers remaining in the market, higher costs and reduced risk in the market. Traders may leave in search of higher leverage, maybe going offshore including to unlicensed brokers. Based on trading records, there may also be groups of profitable traders that will be adversely affected by the proposed measures. It is hard discern what else will happen, for example, to trader's loss ratios.

These results suggest that further investigation of the potential impacts on different groups of traders is warranted.

Limitation of our work

General use restriction

This report is prepared solely for the use of Pepperstone Group Limited. This report is not intended to and should not be used or relied upon by anyone else and we accept no duty of care to any other person or entity. The report has been prepared to assist Pepperstone Group Limited to respond to ASIC Consultation Paper 322: Product Intervention: OTC binary options and CFDs, as set out in our engagement letter dated 16 September 2019. Pepperstone should not use this work for any other purpose.

Appendix A Survey

A.1. CFD Survey 2019

To gain a better understanding of the retail clients in Australia trading CFDs and how ASIC's proposed intervention into the CFD market might impact them, an independent survey was developed and released to a database of Australian based CFD retail clients provided to Deloitte Access Economics by Pepperstone.

The survey itself contained a total of 8 questions. These questions asked retail clients on their experience and trading behaviours with respect to CFDs, and how they might change those trading behaviours, if ASIC's proposed leverage limits, margin close-out and negative balance protection rules were to become effective.

Below is a full extract of the questions asked and alternative answers provided in the *CFD Survey 2019*.

1. How long have you been trading CFDs?
   a) Less than 6 months
   b) 6 to 12 months
   c) 13 months to 2 years
   d) More than 2 years
   e) Don't know/unsure

2. How frequently do you trade CFDs?
   a) High frequency
   b) Daily
   c) Weekly
   d) Monthly
   e) Don't know/unsure

3. Select the leverage that you use most often.
   a) Less than 20:1
   b) 20-50:1
   c) 50-75:1
   d) 75-100:1
   e) 100-125:1
   f) 125-150:1
   g) 150+:1
   h) Don't know/unsure

4. In a recent regulatory consultation, it is recommended that leverage ratios offered to retail clients do not exceed the following limits:
   20:1 leverage on currency pairs and gold = 5% margin
   15:1 leverage on major indices = 6.67% margin
   10:1 leverage on commodities (excluding gold) = 10% margin
   2:1 leverage on cryptocurrency-assets = 50% margin
   5:1 leverage on shares or other underlying assets = 20% margin
   If these caps are implemented, what would you do? Tick as many boxes that apply.
   a) I would not change my trading behaviour or my broker
   b) I would change the size of my trades
   c) I would change the number of my trades
   d) I would change to a broker that offered higher leverage
   e) Stop trading
   f) Don't know/unsure

5. If these caps are implemented, how would you change the size of your trades?[66]
   a) Increase by up to 50%
   b) Increase by more than 50%
   c) Decrease by up to 50%
   d) Decrease by more than 50%
   e) Stop trading

6. If these caps are implemented, how would you change the frequency of your trades?[67]
   a) Increase by up to 50%
   b) Increase by more than 50%
   c) Decrease by up to 50%
   d) Decrease by more than 50%
   e) Stop trading

7. In a recent regulatory consultation, it is proposed to protect retail clients by introducing:
   - *negative balance protection* – limiting the retail client's losses to the funds in their CFD trading account
   - *margin close-out protection* - once the funds in the retail client's CFD trading account fall to less than 50% of the total initial margin on open positions in that account, the CFD issuer will be required to close out one or more open CFD positions held by the retail client.

   If ASIC introduces negative balance protection, at what level, if any, do you think that margin close-out protection for retail clients' should apply?
   a) My margin falls to 50% my trades should be progressively closed out
   b) My margin falls to 20% my trades should be progressively closed out
   c) At no level

8. What is your total annual pre-tax income, from all sources?
   a) Less than $20,000
   b) $20,000 -$35,000
   c) $35,001-$50,000
   d) $50,001-$65,000
   e) $65,001-$85,000
   f) $85,001-$100,000
   g) $100,001-$150,000
   h) More than $150,000
   i) Don't know/unsure
   j) Prefer not to say

9. How long have you been trading CFDs?
   a) Less than 6 months
   b) 6 to 12 months
   c) 13 months to 2 years
   d) More than 2 years
   e) Don't know/unsure

---

[66] Note: This question is only asked when a respondent has selected "I would change the size of my trades" in question 4.
[67] This question is only asked when a respondent has selected "I would change the number of my trades" in question 4.

10. How frequently do you trade CFDs?
    a) High frequency
    b) Daily
    c) Weekly
    d) Monthly
    e) Don't know/unsure

11. Select the leverage that you use most often.
    a) Less than 20:1
    b) 20-50:1
    c) 50-75:1
    d) 75-100:1
    e) 100-125:1
    f) 125-150:1
    g) 150+:1
    h) Don't know/unsure

12. In a recent regulatory consultation, it is recommended that leverage ratios offered to retail clients do not exceed the following limits:
    20:1 leverage on currency pairs and gold = 5% margin
    15:1 leverage on major indices = 6.67% margin
    10:1 leverage on commodities (excluding gold) = 10% margin
    2:1 leverage on cryptocurrency-assets = 50% margin
    5:1 leverage on shares or other underlying assets = 20% margin
    If these caps are implemented, what would you do? Tick as many boxes that apply.
    a) I would not change my trading behaviour or my broker
    b) I would change the size of my trades
    c) I would change the number of my trades
    d) I would change to a broker that offered higher leverage
    e) Stop trading
    f) Don't know/unsure

13. If these caps are implemented, how would you change the size of your trades?[68]
    a) Increase by up to 50%
    b) Increase by more than 50%
    c) Decrease by up to 50%
    d) Decrease by more than 50%
    e) Stop trading

14. If these caps are implemented, how would you change the frequency of your trades?[69]
    a) Increase by up to 50%
    b) Increase by more than 50%
    c) Decrease by up to 50%
    d) Decrease by more than 50%
    e) Stop trading

[68] Note: This question is only asked when a respondent has selected "I would change the size of my trades" in question 4.
[69] This question is only asked when a respondent has selected "I would change the number of my trades" in question 4.

15. In a recent regulatory consultation, it is proposed to protect retail clients by introducing:
negative balance protection – limiting the retail client's losses to the funds in their CFD trading account
margin close-out protection - once the funds in the retail client's CFD trading account fall to less than 50% of the total initial margin on open positions in that account, the CFD issuer will be required to close out one or more open CFD positions held by the retail client.

    If ASIC introduces negative balance protection, at what level, if any, do you think that margin close-out protection for retail clients' should apply?
    a) My margin falls to 50% my trades should be progressively closed out
    b) My margin falls to 20% my trades should be progressively closed out
    c) At no level

16. What is your total annual pre-tax income, from all sources?
    a) Less than $20,000
    b) $20,000 -$35,000
    c) $35,001-$50,000
    d) $50,001-$65,000
    e) $65,001-$85,000
    f) $85,001-$100,000
    g) $100,001-$150,000
    h) More than $150,000
    i) Don't know/unsure
    j) Prefer not to say

Appendix B Interviews

Three brokers provided a total of 50 names for interview. Over two days (19-20 September) Deloitte Access Economics contacted traders at random and asked the questions listed below. From the list of 50 names, 16 were interviewed.

Traders:

1. How long have you been trading for?

2. Why to do trade these products?

3. What leverage do you typically utilise?

4. What are your views on ASIC's proposed measures?

5. What will you do if/when these measures come into place?

6. Would you be willing to continue to trade with an ASIC licensed broker if leverage rates moved to 50:1 and 100:1?

7. Would you consider yourself an experienced trader? Why?

EA Traders:

Same 7 questions as above, plus

8. How long have you employed an EA as your trading strategy?

9. Why have you chosen an EA tool?

10. If ASIC's measures are implemented, how will this impact your EA?

11. How long will it take to reprogram the EA to the new close out/leverage environment?

12. Will you move to another jurisdiction? Does moving to another broker mean you have to make changes? What are those changes and how long do that take to implement?

Appendix C Trading data

The structure of the data received from the CFD providers was:

- account attributes, which provided details about the account which was valid at September 2019
- daily account metrics, which is a daily summary of trading data per account and customer ID
- daily asset class metrics, which is the same as the Daily Account Metrics file, however this is segmented into trades by asset class.

C.1. Analysis Methodology

For the analysis to determine the effect of imposing leverage caps, the data was segmented to those accounts that were under the UK "FCA" license prior to and after the UK implementation of leverage caps. The analysis looks at the number of accounts ceasing to trade around the period of the implementation as well as looking at the timing of opening Australian accounts where the customer has an existing UK licence.

The analysis for the effects of margin close outs compares the distribution percentiles for accounts that have a 50% close out to those that have less than 50% (30%, 20%, or 10%). For this analysis the distribution of daily net profit/loss amounts are compared against each other at the 25th, 50th and 75th percentile levels. This analysis is undertaken at the asset class level, as the loss characteristics differ across asset classes.

Deloitte.

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