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1st October 2019

OTC Intermediary Compliance
Market Supervision
Australian Securities and Investments Commission
Level 7, 120 Collins Street
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Via Email: Market.Supervision.OTC@asic.gov.au

CMC Markets Asia Pacific Pty Ltd Response to CP 322 – Product Intervention: OTC Binary Options and CFDs

CMC Markets Asia Pacific Pty Ltd ("CMC Markets", "our", "us", "we") welcomes the opportunity to comment on the Australian Securities and Investment Commission's ("ASIC") proposals detailed in its Consultation Paper 322: Product Intervention: OTC binary options and CFDs ("CP322").

Executive Summary

CMC is supportive of robust and proportionate measures to raise standards in the industry. We have read CP322 and considered the concerns raised regarding the significant detriment to retail clients, primarily financial losses. While we believe this is predominantly caused by firms conduct and not the products themselves, we endorse ASIC's proposals, subject to the amendments listed below;

- We believe that the Sophisticated Investor Test under the Wholesale Client Category is likely to be abused by firms seeking to circumvent ASIC's product intervention measures, given the subjective nature of the test. We would strongly urge ASIC to overlay the existing test with more stringent and prescriptive criteria applicable to clients of CFDs issuers.
- We request that leverage limits are brought in line with those implemented by ESMA and the FCA in order to reduce the potential for regulatory arbitrage between Europe and Australia and to remove the operational burden for global firms, introduced by the differing limits. Our analysis shows that the reduction in sensitivity of a client's trade to price movements is negligible after a certain point – see appendix 1.
- Conditions 5-7 only appear to apply to CFD platforms maintained by the issuer, which would have the effect of exempting all providers that use third party platforms to issue and distribute CFDs such as MetaTrader 4 and MetaTrader 5. We believe that it is such firms have engaged in poor conduct contributing to a number of the issues faced by retail clients, such as targeting unsuitable audiences. Implementing conditions 5-7 as currently drafted would mean that clients of such firms do not benefit from the additional transparency these conditions are intended to achieve.
- We believe the timeframe proposed for implementation of ASIC's product intervention measures should be extended to 3 months for conditions 1-5, and 6 months for conditions 6-8, in order to allow sufficient time for firms to implement and test the required changes, update key client documentation/assets and provide notice to clients.
- The introduction of negative balance protection for retail clients will increase the capital requirements for firms that will essentially need to provide a guaranteed close out for retail clients. CFD issuers will not receive the same benefit from trades placed with prime brokers to hedge the market risk exposure. As such, we urge ASIC to increase the Net Tangible Asset requirements to at least $2 million or 15% of average revenue.

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1. Preamble

Since launching in 1989, the CMC Markets Group has become one of the world's leading online CFD and financial spread betting providers, with c.67 million trades executed annually across Australia, Europe, Asia and North America. The Group currently has 13 offices in 12 countries globally, servicing clients from over 76 countries worldwide. CMC Markets prides itself on its strong and reputable global brand, providing all products and services in compliance with the laws of jurisdictions from which it on boards.

In addition to its CFD and margined FX business in Australia, CMC Markets Stockbroking Limited is an award winning broker and ASX, Chi-X and SSX participant that services the needs of both a retail and Institutional client base, primarily through its in-house developed online trading platform. Its offering includes shares, options, listed managed investments, warrants and interest rate securities. It also provides ASX clearing and settlements services for two "tier 1" and three "tier 2" Australian banks. In September 2018, CMC Markets Stockbroking migrated approximately 500,000 retail clients from ANZ Share Investing as part of a white label partnership, and is now the second largest stockbroker by market share in Australia.

Some key milestones during the course of CMC Markets Group's expansion have included: the acquisition of the Australian stockbroker Andrew West & Co and CMC Markets Plc listing on the London Stock Exchange in 2016 (trading as CMCX), with an initial market capitalisation of £693m.

CMC Markets was founded in 2002 in Sydney, Australia, and offers CFD and margined FX trading to both retail and wholesale clients. In the Australia Leverage Trading report from Investment Trends dated December 2018, CMC Markets ranked 1st in overall client satisfaction and was ranked number 1 in four of the five key areas that matter to premium traders – platform reliability, ease of use, customer service and value for money. It also ranked number 1 in the premium trader market segment.

2. Introduction

Fair outcomes for clients have always been a focus for CMC Markets. We were the founding members of the Australian Retail OTC Derivatives Association ("Association") in 2011, which represents over 60% of the CFD and margined FX industry in Australia by primary market share. The Association established 16 Best Practice Standards ("Standards") in 2012 for the purpose of continuously improving existing CFD and FX industry standards and addressing specific CFD and FX industry issues and investor concerns. The Standards were built on existing legislation to deliver additional benefits to investors and elevating investor perception and understanding in dealing in CFD and FX products.

CMC Markets supports ASIC product intervention measures for retail clients.

In respect of the proposed product intervention orders, given CMC Markets' global presence (in particular in the UK and Europe), CMC Markets is confident that it is able to harness the experience gained from similar recent UK and European regulatory changes, to provide constructive comment in response to CP322.

Below is an overview of comments from CMC Markets regarding the proposals outlined within CP322. Please note that further detail around these comments is provided throughout this paper when addressing specific questions posed by ASIC.

a) Use of third party systems for FX trading, i.e. Metatrader4 and Metatrader5 ("MT4/MT5"):

CP322 paragraph 215, page 55 states "Another benefit of imposing market-wide conditions is that it applies to all issuers of CFDs equally. It will set an even bar among all CFD issuers..." We agree

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with this notion, however it is clear that a number of the conditions as stated will not achieve this outcome. The applicability of certain system-related functionality and disclosure conditions to only those systems "maintained by the provider" discounts the sole use of third party platforms for FX trading such as MT4/MT5 by the majority of CFD providers whose conduct has led to regulatory product intervention. For example, contrary to CMC Markets' business model, many of these providers have most (if not all) clients located offshore or have chosen to move their client base, including those residing in Australia, into another entity to avoid regulatory scrutiny. Such other entities are often located in "tax haven" jurisdictions with light regulation of financial services. We believe that not applying conditions equally through such system-related exceptions, as proposed in CP322, will undermine appropriate regulatory outcomes and a level playing field in respect of the provision of OTC Derivatives to retail clients in Australia. Clients will be potentially worse off on these platforms as they won't receive the protections from these measures;

b) Lack of consistency with measures introduced overseas:

CP322 paragraph 215, page 55 also states the implementation of conditions will "...provide consistency with measures introduced overseas." We contest this, particularly with regards to Condition 1 (Leverage Ratio Limits), as ratio limits differ from that of two of the world's largest regulators in ESMA and the FCA, resulting in the potential for regulatory arbitrage and operational inefficiency, particularly for global operators such as CMC Markets. We recommend alignment with ESMA and the FCA in this regard. Furthermore, ASIC notes that conditions such as real-time disclosure of total position size (Condition 6) and real-time disclosure of overnight funding costs (Condition 7) are firsts for any regulator globally, yet by excluding MT4/MT5 it is apparent that ASIC has not considered the resultant asymmetrical regulatory outcome and impact on competition;

c) Potential misuse of wholesale client criteria:

As discussed in our most recent meeting with ASIC, we are concerned about the potential for, or actual misuse of certain wholesale client criteria, specifically the sophisticated investor test under section 761GA of the *Corporations Act 2001* (Cth) ("Sophisticated Investor Test"), to re-categorise retail clients as wholesale clients, upon implementation of these measures. To address this potential for misuse, we think ASIC should consider implementing more prescriptive requirements for the Sophisticated Investor Test, or publish guidance on its expectations around how it expects CFD issuers to apply the test. Our proposals on this are noted in more detail, later in this response. Given the potential for the misuse of the Sophisticated Investor Test being exacerbated by the introduction of the product intervention orders, we think this could perhaps be addressed as part of Product Intervention Orders that ASIC implements. Due to recently observed behaviour in the industry, we are also encouraging stronger monitoring by ASIC in respect this test, and the $500,000 investment-based financial product test (Section 761G(7)(a) of the Corporations Act), as applicable to OTC Derivatives;

d) Timing for implementation:

We believe that the tight timeframe proposed will negatively impact client experience and jeopardise firms ability to comply with the conditions to an appropriate standard. The reasons for this are referenced in more detail within our response, but include required system changes and quality assurance testing, client communications with reasonable notification of changes, documentation amendments (including legal and disclosure documentation), changes in education material, readiness in terms of updating governance and compliance frameworks (including compliance monitoring and various policy and procedures), and resource planning given constraints during a potential traditional period of IT change freeze. CMC Markets' primary objective will be to ensure clients are given adequate notice in order to understand the proposed changes and that clients are provided with a seamless experience overall.

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To this end, we propose a 3 month implementation timeframe for conditions 1-5 and 6 months for conditions 6-8;

e) Licensing - Financial Requirements:

It is important for retail OTC derivative providers to maintain adequate financial resources to ensure they remain financially viable and to assist in covering operational risk events. ASIC Regulatory Guide 166.322 outlines a Net Tangible Asset ("NTA") requirement of the greater of $1 million or 10% of average revenue. We note that this last changed from an NTA requirement of $500,000 in February 2014. We believe the financial buffer required to mitigate the risk of a disorderly or non-compliant wind-up if a business fails should be more closely aligned to the increasing risk for issuers and consumers alike. This risk has come about given the growth in the OTC Derivatives industry in Australia and the resultant increasing necessity for available capital to mitigate operational risk events. The introduction of negative balance protection as proposed in CP322 will heighten the need for increased issuer capitalisation to adequately cover client positions. We strongly believe the NTA requirement should be increased to at least $2 million or 15% of average revenue, as was previously introduced in the Association Standards.

3. Specific responses to the Questions posed:

Binary options:

Question E1Q1 - Do you agree with our proposal to make a market-wide product intervention order which prohibits the issue and distribution of binary options to retail clients? If not, why not? If you disagree that binary options have resulted in, and are likely in future to result in, significant detriment to retail clients, please provide evidence and data in support of your view.

Yes we agree.

Question E1Q2 - Do you agree with our proposal that the order would remain in force for a period of 18 months? If not, why not?

Yes we agree.

Question E1Q3 - Do you agree that our proposed delayed commencement of the order is appropriate, balancing the time it will take to implement the order and the nature, likelihood and extent of the significant consumer detriment? If not, what is an appropriate period?

We would like to propose 3 months in order to allow us to update our legal documentation, platform and websites, education and marketing materials to remove references of these products.

Question E1Q4 - Do you agree with our identification of the effects that making the proposed product intervention order will have on competition in the financial system? If not, why not?

Yes we agree.

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CFDs:

Question F1Q1 - Do you agree with our proposal to make a market-wide product intervention order which imposes Conditions 1–8 (set out in Table 5) on the issue and distribution of CFDs to retail clients? If not, why not? If you disagree that CFDs have resulted in, and are likely in future to result in, significant detriment to retail clients, please provide evidence and data in support of your view.

CMC Markets believes it is important to strengthen protection for retail clients and accordingly supports ASIC in its endeavours to implement stronger measures through the proposed product intervention orders. There are, however, a number of key concerns where we would strongly advocate change to ensure even higher regulatory standards, a level playing field and more consistency with other main regulators globally.

We set out our specific responses to each condition outlined within CP322 as follows:

1) CP322 CFD Condition 1 – Leverage ratio limits:

CMC Markets supports the introduction of leverage restrictions. However, the proposed leverage ratio limits differ from that of two of the world's largest regulators, ESMA and the FCA. Unlike ESMA and the FCA:

- ASIC do not propose to distinguish between major and minor currency pairs, proposing 20:1 for CFDs over currency pairs or gold, while ESMA and the FCA implemented 30:1 for major currency pairs; and
- ASIC also proposes a standard 15:1 for CFDs over stock market indices, while ESMA and FCA implemented a 20:1 and 10:1 for major and non-major indices respectively.

ASIC's reasoning for this approach is simplicity in implementation and supervision, and alignment with other regulators in the region. However, from an operational viewpoint, this increases the burden on global firms, such as ours.

Also, ASIC's rationale of limiting regulatory arbitrage by aligning limits with other regional (localised) jurisdictions is inconsistent with the global nature of CFD trading, which goes beyond regional boundaries. If ASIC were to align leverage ratio limits with ESMA and the FCA, the differences in client outcome from a leverage limit of 20:1 versus 30:1 is negligible. Refer to **Appendix 1 Figure 1** which demonstrates this in a graphical analysis in respect of leverage per unit of price move.

Despite the minimal difference in client outcomes, we do not think this will be at the forefront of clients' minds and clients will still be attracted and will give preference to the notion of higher leverage. This ultimately would lead to Australian investors seeking out higher leverage in these instruments beyond our region if there is this opportunity.

The December 2018 Investment Trends Leveraged Trading Report for instance, shows low leverage as a growing factor in the past year, more than any of the previous 5 years and before, as a reason CFD/FX traders stopped using their ex-provider. Also, 19% of CFD/FX traders listed education on how leverage works in the top 10 of the most desired education overall. This shows an ongoing trend towards a desire for more knowledge of, and exposure to, higher leverage, increasing the likelihood of regulatory arbitrage.

We therefore propose that all leverage ratio limits are aligned with ESMA and the FCA. This takes into consideration ASIC excluding government bonds from qualifying under 'other underlying assets' and aligning to the FCA, with a suggested minimum margin requirement for sovereign debt of 3.33%. In their consultation paper CP18/38, the FCA noted that both firm and consumer feedback was that 5:1 leverage limits were disproportionate for this asset class (sovereign debt) due to their historic low volatility. Please

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refer to **Appendix 1 Table 1,** which further augments this stance by comparing recent historical volatility and CVaR.

ASIC has clarified in recent discussions with CMC Markets that proposed limit ratios would apply to "new" orders post the implementation of the instrument. The approach taken by CMC Markets Group in respect of the ESMA margin changes was to set up duplicate instruments for all asset classes (excluding shares) in order to effectively only implement the respective margin changes on new trades. CMC Markets proposes to adopt the same approach to ASIC changes (if implemented). Our analysis indicates that around 25% of clients impacted by ASIC's proposed leverage ratio limits would be liquidated if they did not reduce exposure or fund their trading account to ensure sufficient margin. A high level summary showing number of APAC clients holding positions, the number of those who would be above 100% coverage, those between 50% and 100% coverage (i.e. on a margin call) and those less than 50% coverage (i.e. liquidated) following immediate implementation of ASIC's proposed leverage ratio limits can be found in **Appendix 1 Table 2.**

From Appendix 2 of CP322 it is our understanding that ASIC wants to achieve a holding period of circa 2 days with a 95% confidence level. In respect to the FCA CP 16/40, CMC Markets Group compiled a paper that offers a quantitative assessment of the effect leverage has on the likelihood of realising a loss over a given holding period due to taking a position in a CFD that has an automated 'close out'. This paper is presented in **Attachment 1** to this response. An asset class neutral nonparametric ('historic VaR') model was proposed which estimated the minimum margin required to not be 'closed out'/ 'survive' over a specified holding period with a defined level of confidence. Surfaces are generated to enable the visual assessment and comparison of the risk profiles of a selection of instruments. If ASIC is interested in using this analysis to quantitatively compare its suggested margins vs that of ESMA we would be happy to calibrate the model accordingly and share the results.

We believe, in line with our response to other conditions, a proposed implementation timeframe of 20 business days is not conducive to a smooth and efficient implementation due to:

- the system changes required with amendment of multiple schemas to implement the new requirements;
- the need for appropriate quality assurance testing to ensure system compliance devoid of any bugs and defects;
- the documentation changes required, including updating of disclosure documentation and relevant Policies & Procedures;
- internal staff training in respect of the new requirements in order to continue to effectively service our clients;
- the need to streamline client communications and effectively manage system development resourcing requirements; and
- allow clients sufficient time to either reduce their exposure or transfer additional funds in relation to any trades on shares, for which CMC Markets will not be able to set up duplicate instruments.

For operational efficiency, we suggest alignment with other key suggested timeframes within our response that requires development work, namely 3 months from the date of publication of the final Product Intervention Order. We note that ESMA gave approximately 4 months' lead time after publication of the final measures.

2) *CP322 CFD Condition 2 – Margin close-out protection:*

We agree with ASIC's proposal. Refer to our response to QF1Q2 below which requests specific feedback on the preferred approach to margin close-out.

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3) *CP322 CFD Condition 3 – Negative balance protection:*

We agree with ASIC's proposal. Whilst CMC Markets welcomes this requirement to protect the financial positions of retail clients, we note that the risk transfer from the client to CFD provider calls for increased capital obligations. ASIC should increase financial adequacy under ASIC Regulatory Guide 166: *Financial requirements* in respect of NTA requirements to at least $2 million or 15% of average revenue to ensure that issuers of retail OTC derivatives products have sufficient financial resources to conduct their financial services businesses in compliance with the Corporations Act. Increasing NTA requirements will provide an additional financial buffer to reduce the risk of issuer failure and protect retail clients who may suffer as a result of unexpected collapse of a CFD issuer, the likes of which we have seen in the past.

Again, implementation within 20 business days of the instrument being passed is a very tight timeframe to update our documentations and roll out system changes alongside all other condition requirements, if passed. We strongly suggest a longer implementation date of 3 months for this condition.

4) *CP322 CFD Condition 4 – Prohibition on inducements:*

CMC Markets supports the prohibition on offering inducements to retail or prospective retail clients given the potential for these to target those who may not have the knowledge or sufficient financial resources to be trading CFDs.

We note that there is a risk that providers may offshore Australian clients into other jurisdictions that may allow these firms to operate with little or no meaningful regulatory supervision, and these firms are likely not implement these measures, and in fact see a commercial opportunity in marketing aggressively (particularly in the digital space) to Australian retail clients. Such clients who are onboarded by these firms will be exposed to other poor practices (e.g. in respect of sales, execution and/or disclosure) and the likely loss in investor protections will lead to poor client outcomes. We strongly encourage ASIC to actively monitor and prevent such practices where possible, using whatever enforcement measures necessary whilst engaging with offshore regulators to stamp out poor marketing practices.

5) *CP322 CFD Condition 5 – Risk warnings:*

We agree with ASIC's proposal. CMC Markets strongly supports the use of risk warnings that are fair and proportionate to the relevant medium. Refer to QF1Q3 which requests specific feedback on risk warnings, and our relevant response.

6) *CP322 CFD Condition 6 – Real-time disclosure of total position size:*

CMC Market's Next Generation CFD platform currently allows clients to view the total notional value of all their open CFD positions, updated on a real-time basis. Whilst CMC Markets platform already complies with this condition, we are concerned that the wording in both condition 6 and condition 7 states these system requirements are only applicable 'in any trading platforms maintained by the CFD Issuer'. This wording excludes providers using third party platforms such as MT4/MT5 from complying with this condition 6 and condition 7, as well as condition 5: risk warnings, as it applies to platform disclosure. In order for ASIC's product intervention measure to be effective, we believe the must be applied consistently across all firms.

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7) ***CP322 CFD Condition 7 – Real-time disclosure of overnight funding costs:***

We understand the concerns outlined by ASIC in CP322 in regards to some providers not being transparent on the actual overnight funding costs that are charged on certain contracts. CMC Markets has been a global industry leader in providing clients with pricing transparency since 2013, when we updated our platform to enable clients to view historical holding cost (displayed as an annualised rate of interest). We believe that no other provider in our sector globally provides the same level of holding cost visibility. We supply historical charges, individual cost statements and further information pages including the fees and calculation methodology for holding costs. This ensures we have a standardised and consistent approach on our fees and costs.

CMC Markets clients can view the most recent rates (to 5pm New York time), displayed as an annualised rate of interest, for both Buy and Sell Positions for the last 17 days on each product. This feature is available to all clients who have access to our platform and not just specific to clients who hold an open order. This means that all clients can access historical charges and take this into consideration prior to placing an order. This feature also allows clients to view if there has been any significant movements in charges on products prior to placing orders. Refer to the **Appendix 1 Figure 2**, which demonstrates how this appears on our platform.

Fees and associated methods of calculating holding costs are also outlined clearly to clients on our website. CMC Markets provides multiple information pages and these pages are further linked to prominent traffic areas of the site where we specifically mention fees.

Our platform provides clients with clear and transparent historical holding cost charges, enabling clients to better understand the associated charges and fees prior to placing their order. We recommend that ASIC considers this feature as an alternative to this condition and we would be happy to provide ASIC will a detailed demonstration of how this works on our platform.

CMC Markets is also concerned that this condition, along with real-time disclosure of total position size (CFD Condition 6) and risk warnings (CFD Condition 5) does not apply to MT4/MT5 users, which will lead to less disclosure to retail clients and unfair competition skewed in favour of the "longer tail" of the industry who predominantly use MT4/MT5.

The extensive use of MT4/MT5 is demonstrated by industry research - Australian CFD providers held the top 3 positions in respect of trading volumes on MT4/MT5 in Q2 21019, accounting for $975.8 billion in volumes for the quarter with an average of 92% of their business utilised through MT4/MT5. CMC Markets utilised 2% of business through MT4/MT5 over the same period, with a volume in $3.6 billion. According to data gathered by Finance Magnates' Intelligence Department, MT4's market share amongst top brokers still looks very healthy. Throughout 2018, and in individual quarters, around 50-55% of providers offered MT4.

https://www.financemagnates.com/forex/technology/forex-brokers-arent-ready-to-let-go-of-mt4-anytime-soon/

Real-time disclosure of overnight funding costs will require significant front end development work to enable CMC Markets to comply with this requirement, with an estimation of 6 months to implement, beyond the proposed implementation timeframe of 3 months.

8) ***CP322 CFD Condition 8 – Transparent pricing and execution:***

CMC Markets supports the introduction of transparent pricing and execution. As per our recent discussions with ASIC, we suggest ASIC monitors the adherence to this condition throughout the sector to ensure that all providers not only have a policy, but are monitoring the effectiveness of their pricing and execution arrangements in line with regulatory obligations.

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QF1Q2 - Condition 2 would require the terms of a CFD to provide that a CFD issuer must close out one or more of a retail client's open CFD positions, if the retail client's funds in their CFD trading account fall to less than 50% of their total initial margin required for all of their open CFD positions on that account. Do you agree with this condition or would it be better for clients (and operationally easier) if the CFD issuer is required to close all of the retail client's open CFD positions?

The current CMC Markets process in respect of margin close-out is that once close out levels (50%) are triggered, full account close out is initiated unless the client opts to choose an alternative method to close-out one or more positions, until the client's equity level is back above the liquidation level. More specifically, the account close-out method optionality in account settings within the platform provides alternative close-out methods of standard (full close-out), first in first out, last in first out, large position margin first and largest position loss first methodology. An explanation of each as displayed on our platform is provided in **Appendix 2**.

We believe there are advantages in providing alternative close-out methods to full account close-out. A per-account margin close-out is more industry standard and serves to protect clients who do not fully understand or are not accustomed to a per-position close-out methodology, hence our default position on close-out. A position close-out methodology as an alternative promotes a potentially fairer and more efficient outcome for the client.

We acknowledge that close-out methodology across the industry may not be wholly standardised or transparent. For this reason and for ease of implementation, we believe as a minimum full account close-out should be offered as a default by all providers, however where there is a desire and capacity to offer alternative close-out methods in addition to full account close-out, this functionality should be available for clients.

QF1Q3 - Condition 5 would require a CFD issuer to provide a prominent risk warning on account opening forms, trading platforms maintained by the CFD issuer, websites and the front page of PDSs. Do you agree with this condition? Do you think a risk warning should also be required on all advertising and marketing material?

Yes we agree, subject to our comments below:.

- In relation to the 'issuer specific warning' as required under Condition 5, it would appear that a possible interpretation of the definition of the 'applicable 12 month period' is that the timelines mentioned are pegged to the 'issue of the CFD'. We interpret an application of this as requiring a CFD issuer to update its 'issuer-specific risk warning' at least on a quarterly basis to ensure that at any point in time, a CFD is issued with the 'Loss Making Account Percentage' relating a to 12 month period, not being older than 3 months prior to the issue of a CFD. CMC Markets considers that this may be an unintended outcome of this drafting and as it is a requirement applying to the PDS, it would be considerably cumbersome to implement a quarterly update to the PDS, bearing in mind notice requirements to clients, along with other updates which may not be possible to align. We think ASIC should consider clarifying that the timelines in the definition of 'issuer specific warning' so that these are pegged to the date of PDS, by adding wording in (b) of the definitions such as '*ends no earlier than 3 months before the date of the PDS that relates to the issue of the CFD*';

- Alternatively, if quarterly updates to the issuer specific risk warning are required, we would propose that ASIC consider revisiting the prescribed content of the warning itself, so that the 'Loss Marking Account Percentage' % is not specified but is accessible through a link noted in the warning, to a CFD issuer's webpage. We would propose this specifically with respect to the requirement to have this risk warning in the PDS, as it would address the issues raised in relation to the logistics of implementing

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(at least) quarterly legal document updates for this purpose. We further note that, it may also be beneficial to mention the 12 month period to which the percentage relates.

We also believe that risk warnings should be fair and proportionate to the medium. Whilst this condition mostly achieves this, for mobile applications, suggested warnings would take up a significant portion of multiple screen space, detracting from the customer experience. We suggest a short-form risk warning option for mobile applications.

We are concerned that certain providers who engage in irresponsible practices may have a weaker interpretation on what is "prominent" in respect of risk warning placement. We would welcome more specific guidance from ASIC on this, particularly in regards to website and platform positioning of the risk warnings. Users of MT4/MT5, as the conditions are proposed, will not be obliged to comply with platform risk warnings which will likely contribute to detrimental client outcomes.

We are also aware that some providers, as part of their CP322 response, will argue for sector-wide (averaged) win/loss ratios. We think clients would be better informed if providers disclose win/loss ratios specific to their business.

Question F1Q4 - Do you agree with our proposal that the order would remain in force for a period of 18 months? If not, why not?

Yes, we agree.

Question F1Q5 - Do you agree that our proposed delayed commencement of the order is appropriate, balancing the time it will take to implement the order and the nature, likelihood and extent of the significant consumer detriment? If not, what is an appropriate period?

As noted earlier in the introduction to this response, the multiple and tight implementation timeframes are unrealistically ambitious and will jeopardise the smooth and efficient implementation of the conditions as proposed. The suggested timeframes are referenced throughout our response in more detail, but our reasoning for an extension in timeframes include the degree of system changes and quality assurance testing required, client communications with reasonable notification of changes, documentation amendments (including legal and disclosure documentation), changes in education material, readiness in terms of updating governance and compliance frameworks and resource planning given constraints during a potential traditional period of IT change freeze. We propose a 3 month implementation timeframe conditions 1-5 and 6 months for conditions 6-8 as noted throughout our response, to promote overall readiness and operational efficiency for the benefit of clients and providers alike.

Question F1Q6 - Do you agree with our identification of the effects that making the proposed product intervention order will have on competition in the financial system? If not, why not?

As stated in the introduction to this response and in respect of CFD Condition 5: Risk warnings, Condition 6: Real-time disclosure of total position size and Condition 7: Real-time disclosure of overnight funding costs, CMC Markets contests the summation by ASIC in CP322 p55 which states "Another benefit of imposing market-wide conditions is that it applies to all issuers of CFDs equally. It will set an even bar among all CFD issuers..." This is due to system requirements being applicable only to "...any trading platforms maintained by the CFD Issuer". The wording excludes providers using third party platforms such as MT4/MT5 which would be competitively disadvantageous to providers who maintain a proprietary trading platform, such as CMC Markets. We also contest that this exception in not in the spirit of this product intervention in respect of disclosure and retail client protection. We suggest that conditions 6 and 7 in particular apply to all CFD issuers equally or are carved out, noting that there are no similar requirements to conditions 6 and 7 by any other regulator in any other jurisdiction.

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4. Other considerations

Wholesale Client Criteria

The majority of the tests in the Corporations Act under which clients can be classified as "wholesale" (such as the professional investor test, investment value test and wealth test) are objective and consistent with tests in other jurisdictions. As touched upon earlier in this response, the test for sophisticated investors allows clients to be classed as wholesale where the CFD issuer is satisfied based on 'reasonable grounds' that the client has the requisite knowledge and experience which does not require any judgement on the CFD issuer's part. This is inconsistent with other jurisdictions, which are more prescriptive with respect to assessing experience and knowledge. Given the application of the sophisticated investor test is in some respects subjective, given its reliance on the CFD issuer forming the view, we think without more prescriptive criteria or guidelines, its application is open to uncertainty and errors in judgement. Although we are cognisant of a correlation between knowledge and experience with degree of sophistication, we are concerned that certain providers are inclined to use this subjectivity to their advantage and "game" this test by opting clients out of product intervention through the use of relatively weak experience and knowledge criteria.

We note that in the past, Treasury has considered corresponding laws in overseas jurisdictions and proposed options for reforming the wholesale-retail distinction, but we believe the timing is right for a revisit of this initiative, in particular for the sophisticated investor criteria.

One solution may be to provide a more prescriptive test that requires firms to ensure that clients successfully pass a knowledge-based test in addition to demonstrating that they meet experience part of the sophisticated criteria. This is the approach that we have decided to adopt.

We have also observed behaviour in the industry where the investment value criteria ($500,000) is based on the notional value of a CFD position rather than the actual value of an investment. We encourage ASIC to utilise its enforcement powers to address such misuse of testing criteria.

CMC Markets welcomes the opportunity to provide further information or clarification on any of the matters raised in this CP322 response, and remain open to ongoing consultation with ASIC in respect of the implementation of these important changes to the OTC Derivatives Industry in Australia.

Yours Sincerely,

P.P

Paul Casey
Head of Compliance & Operational Risk
CMC Markets Asia Pacific & Canada
[redacted]

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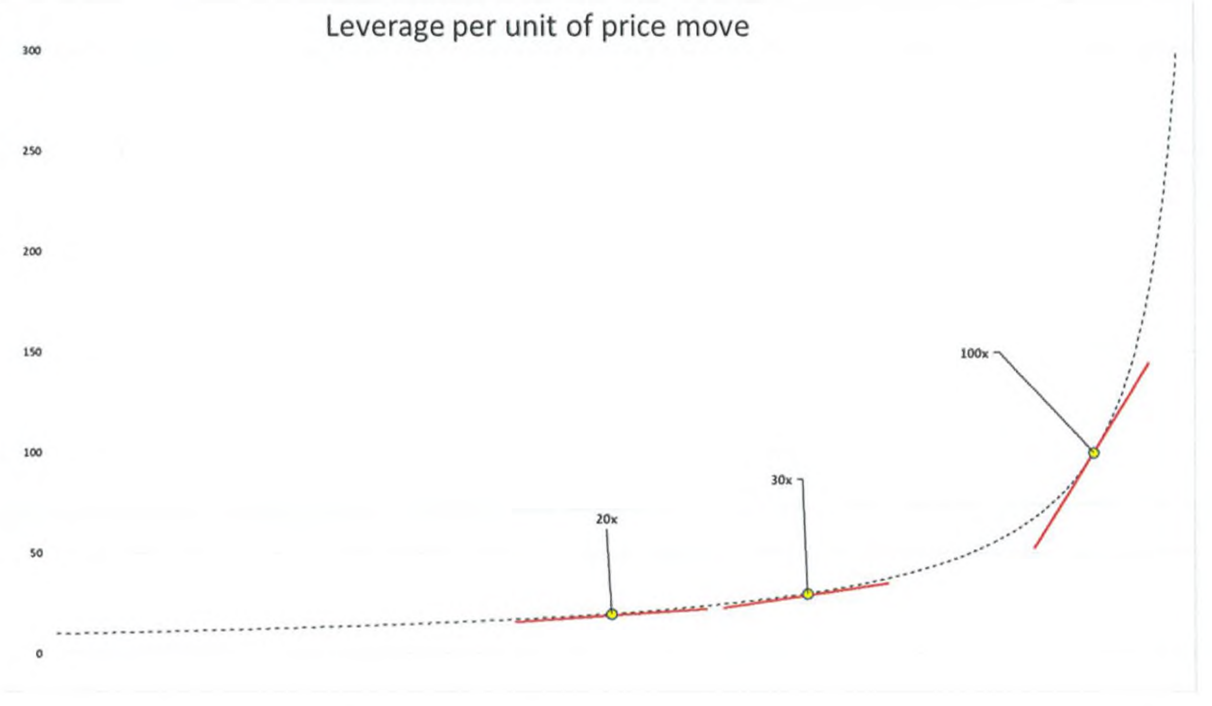
Appendix 1:

Figure 1:



The gradient of the tangent to the curve is the velocity of leverage. The curve can be thought of as showing for a given leverage how sensitive your total equity is to the PnL generated by market moved.

As one can see, the tangents to the curve for 20 times leverage and 30 are virtually parallel, showing that the sensitivity to price move is very similar.

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Table 1:

Table 1 compares Fixed Income instruments to that of a selection of instruments from other assets classes, looking at both average volatility[1] and CVaR[2].

As shown below, the Fixed Income asset class displays disproportionately lower volatility and CVaR results to those instruments of other asset classes, which supports CMC Market's recommendation for ASIC to align minimum margin requirement for sovereign debt with the FCA of 3.33%.

	Instrument	BBG Vol 30d	CVaR Hist 95 5YR
Index	AUSSIE200	16.9%	2.0%
	US30	21.6%	2.2%
	UK100	17.0%	2.1%
	GERMAN30	19.3%	2.7%
FX	AUDUSD	6.0%	1.4%
	EURUSD	5.2%	1.2%
	GBPUSD	7.6%	1.4%
	USDJPY	8.8%	1.4%
Commod	XAUUSD	13.1%	1.8%
	XAGUSD	21.7%	3.4%
	USCRUDEOIL	43.2%	5.2%
Fixed Income	EURIBOR	0.3%	0.0%
	EURODOLLAR	1.0%	0.0%
	EUROSCHATZ	0.5%	0.1%
	EUROBOBL	1.3%	0.3%
	EUROBUND	3.6%	0.7%
	SHORTSTG	0.2%	0.0%
	GILT	4.6%	0.8%
	TNOTE2YR	1.9%	0.1%
	TNOTE5YR	3.9%	0.3%
	TNOTE10YR	5.6%	0.6%

[1] Source = Bloomberg
[2] 95% a 1 day holding period with 5 year look back. Source = MSCI RiskMetricsTM

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Figure 2:

Within 3 clicks from the platform login page, the most recent rates (to 5pm New York time) are available from the 'product overview' page. This page allows client can view the historical rates for both Buy and Sell positions for the last 17 days.

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Table 2:

28 August

Tot Pos APAC Client	% of All	3,687	100.0%
Pos APAC Client >100%	% of Tot Pos APAC	2,003	54.3%
Pos APAC Client >50% & <100%	% of Tot Pos APAC	752	20.4%
Pos APAC clients <50%	% of Tot Pos APAC	932	25.3%

29 August

Tot Pos APAC Client	% of All	3,647	100.0%
Pos APAC Client >100%	% of Tot Pos APAC	1,962	53.8%
Pos APAC Client >50% & <100%	% of Tot Pos APAC	712	19.5%
Pos APAC clients <50%	% of Tot Pos APAC	973	26.7%

23 September

Tot Pos APAC Client	% of All	3,771	100.0%
Pos APAC Client >100%	% of Tot Pos APAC	2,048	54.3%
Pos APAC Client >50% & <100%	% of Tot Pos APAC	716	19.0%
Pos APAC clients <50%	% of Tot Pos APAC	1,007	26.7%

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Appendix 2:

Account Close Out Method

Standard Account Close-Out

☐ **Standard**

Close all Trades on your Account in respect of CMC Markets Products that are within their applicable Trading Hours and where trading is not otherwise suspended, at the first Price available for a Market Order for the relevant CMC Markets Product (taking into account the Stake for the Trade). After this Initial Close-Out, Subsequent Close-Outs may be carried out until your Account revaluation Amount increases above the Close-Out Level.

Alternative Account Close-Out

☐ **Last in, first out**

Will first close the whole or a portion of your most recent Trade, then the whole, or a portion of your next most recent Trade, continuing this process as necessary in order to attempt to increase your Account Revaluation Amount above the Reset Level.
(In respect of the Products that are within their applicable Trading Hours and where trading is not otherwise suspended.)

☐ **Large Position Margin first**

Will first close those Positions for which the Position Margin is largest, continuing as necessary in order to attempt to increase your Account Revaluation Amount above the Reset Level. Where only one Position remains, Trades comprising that Position will be closed on a 'first in, first out' basis.
(in respect of the Products that are within their applicable Trading Hours and where trading is not otherwise suspended.)

☐ **Largest Position loss first**

Will first close those Positions for which the Unrealised Loss is largest continuing as necessary in order to attempt to increase your Account Revaluation Amount above the Reset Level. Where only one Position remains, Trades comprising that Position will be closed on a 'first in, first out' basis.
(in respect of the Products that are within their applicable Trading Hours and where trading is not otherwise suspended.) If at Account Close-Out you have an open Position in a Product that is greater than the maximum Trade size in that Product, then Account Close-Out will be performed on a 'last in, first out' basis, irrespective of which Account Close-Out method has been selected.