



EIGHTCAP PTY LTD

ABN 73 139 495 944 | AFSL 391441

L 6, 360 Collins Street, Melbourne, VIC 3000, AU
+61 3 8373 4800

customerservice@eightcap.com

www.eightcap.com

30 September 2019

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

Email: Market.Supervision.OTC@asic.gov.au

Dear Sir/Madam,

Re: Eightcap response to ASIC's Consultation Paper 322

Please see below from Eightcap Pty Ltd (**Eightcap**) our response to the ASIC Consultation Paper 322 Product Intervention: OTC binary options and CFDs:

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.

Eightcap provides its feedback in response to the proposed conditions 1-8 (set out in Table 5) on the issue and distribution of CFDs to retail clients in *Annexure A: Response to ASIC CP322-F1Q1* – please see attached.

F1Q2 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?

We do not agree that closing out all of a retail client's open CFD positions will be better for clients. We submit that if a retail client's funds in their CFD trading account falls to less than 50% of their total initial margin required for all of their open CFD positions, then open positions should be closed one-at-a-time on that account.

Closing out all of the clients open CFD positions would cause detriment to the client as it would require a client to hold additional capital to reopen closed position(s). Further, clients who re-open their trade positions will incur additional costs to do this.

The Metatrader trading platform offered to clients does not have the in-built functionality that allows for the immediate close out of all client open CFD positions (at a determined close out level). An external plugin would therefore be

required to give effect to the requirements of any such ASIC imposed condition, in effect requiring brokers to 'hack' client's trading platforms.

F1Q3 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?

We do not agree with this Condition and submit that risk warnings should not be required on all advertising and marketing material.

We do not believe there is sufficient evidence to support the implementation of additional risk warning requirements to be placed on all advertising and marketing material in and above those proposed to be displayed on account opening forms, trading platforms maintained by the CFD issuer, websites and the front page of PDS – we consider these places to be the main 'touchpoints' for clients during the on-boarding process.

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

We do not agree that an 18-month enforcement period of the proposal would be reasonable.

We believe that the proposal requires more empirically substantiated evidence of Australian retail clients to justify such significant changes. As per our submission we believe that the majority of the Conditions proposed are poorly researched, factually inaccurate and based a non-representative subgroup of licensees, clients and other stakeholders.

We further submit that we believe there was inadequate pre consultation with the industry prior to the issuing of Consultation Paper 322 and had pre consultation been properly undertaken it would have yielded a more industry specific distillation of the appropriate areas to regulate and take into account client behaviours and technological implications.

If implemented, the changes would be so significant that they may result in irreparable damage to the industry.

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?

We believe that delayed commencement is required however the proposed application dates are not sufficient enough to allow for freeing up capital and reworking trading strategies for clients.

We submit that the Consultation Paper erroneously assumes that consumer detriment has occurred or is likely to occur with respect to CFD products. Further consultation with the industry is required to overcome such a deficiency.

To properly assess if consumer detriment has been reduced by a proposed intervention, incremental implementation ought to be considered. For example, Condition 1 proposes leverage caps on CFD products. We submit that incremental implementation of leverage caps, consistent with the United States and Japan would allow ASIC to determine whether its interventions have their intended effect and allows the regulator to vary product interventions where its outcomes do not align with expectations.

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?

We seriously doubt that the proposed product intervention order would achieve the intended effect upon competition in the financial system. With respect to the conclusions that ASIC has made in CP322 we provide our reasons for disagreement below:

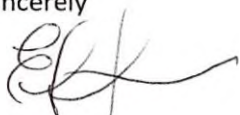
- Paragraph 213 – We disagree that the Conditions will create harm reduction and clients will be less confused.
- Paragraph 214 - We do not believe the reduction in retail client detriment that the proposed intervention will provide outweighs these concerns because of the nature of the product clients will look elsewhere to brokers in other jurisdictions where they will have the leverage that they wish trade with. Consequently, more Australian clients will need to trade with offshore brokers offering higher leverage ratios.
- Paragraph 215 - Imposing Australian market-wide conditions means that they apply to all Australian issuers of CFDs equally. However, it does not apply to overseas issuers whom Australian clients may nevertheless trade with.
- Paragraph 216 - We do not agree that losses will be due to losses avoided by retail clients as these losses will be due to the loss of clients not trading with Eightcap due to the harsh proposed conditions and clients will continue to trade albeit offshore.

We believe our clients have a strong knowledge of the financial systems of markets however there is an inference that all clients are uneducated and unaware of the financial products we offer.

As an Australian regulated entity who will suffer significant detriment from the implementation of these proposed conditions, we consider that it would be unjustly punitive for ASIC not to seriously consider the short- and long term impacts that these conditions would have upon Eightcap. We deem it to be necessary that ASIC provide us with no less than an individualised response to the matters raised in our submission.

We look forward to your response on this matter.

Yours sincerely



Elle Jones

General Counsel, Head of Legal and Compliance

Annexure A: Response to ASIC Consultation Paper 322: Product intervention: OTC binary options and CFDs - F1Q1

Condition 1. Leverage Ratio Limits		Feedback
Requirement	<p><i>Minimum initial margin requirements on CFDs issued to retail clients are applied such that leverage ratios offered to retail clients do not exceed the following limits at the time of issue:</i></p> <ul style="list-style-type: none"> • 20:1 for CFDs over currency pairs or gold; • 15:1 for CFDs over stock market indices; • 10:1 for CFDs over commodities (excluding gold); • 2:1 for CFDs over crypto-assets; and • 5:1 for CFDs over shares or other underlying assets. <p><i>The leverage ratio limits take into account any leverage inherent in an underlying reference asset (e.g. a CFD on a futures contract, an option contract or a leveraged exchange traded fund).</i></p>	<ul style="list-style-type: none"> • Eightcap disagrees with the proposed restrictions for each of the listed products. Specifically, we believe the proposed leverages are arbitrary and cannot be justified by contemporary literature. • For example, ASIC relies on the findings of Hiemer & Simsek (2019) (at 174 – 5) who conclude that the Commodity Futures Trading Commission (CFTC) cap on leverage that brokers may provide to U.S. traders - 50:1 on all major currency pairs and 20:1 on minor currencies “improves belief-neutral social welfare without reducing market liquidity”. We believe that the authors conclusion reveals the balancing considerations that the United States regulator placed in determining its leverage ratio cap. • Meanwhile ASIC has not proposed to distinguish between major and minor pairs in setting leverage ratio limits citing that “it will be simpler to supervise and be consistent with regulators in the region” (at Table 6: Rationale for leverage ratio limits and international comparisons), including South Korea (10:1) who have reported year-on-year trading volumes following the changes (at 180). Therefore, we submit that ASIC’s leverage cap ratio is arbitrary rather than based on empirical data and secondly that the intended reduction in the magnification of fees and costs to consumers proposed by Condition 1 could be achieved using a higher or differentiated leverage for CFDs. • The evidence provided by ASIC with respect to the ESMA introduced temporary product intervention powers to

		<p>validate a large change (at 130) does not take into consideration the volatility of the markets during that period.</p> <ul style="list-style-type: none"> • There appears to be a positive correlation between the number of Brokers offering high leverage to low leverage jurisdictions which we believe is the result of clients wishing to trade with high leverage ratios trade offshore. • Leverage restrictions will not in itself protect clients from trading. Clients will seek alternate trading options offshore and will consequently forgo the protections that ASIC is claiming to be providing.
Application Date	<i>20 business days after the day on which the legislative instrument is registered</i>	<ul style="list-style-type: none"> • Eightcap does not believe this is a reasonable amount of time to advise existing clients who are actively trading. In addition the change would require significant time to update legal document, amend technology platforms and notify clients of the effective change. • Given the drastic changes to the trading strategies for clients due to the restricted proposed leverage, and the requirements for clients to have significantly more funds in their accounts there is a risk that clients' accounts will be closed out if they do not have the required margin and they will experience significant detriment.

Condition 2. Margin close-out protection		Feedback
Requirement	<i>The terms of a CFD offered to a retail client must provide that, if a retail client's funds in their CFD trading account fall to less than 50% of the total initial margin required for all of their open CFD positions on that account, a CFD issuer must, as soon as market conditions allow, close out one or more open CFD positions held by the retail client.</i>	<ul style="list-style-type: none"> • We accept this proposed change however we believe that given Condition 3 below this requirement will become redundant. • EightCap does close trades if retail clients trading accounts fall to less than 50% of the total initial margin required for all their open CFD positions on that account. This is automatic and applies to all clients. • EightCap closes the largest losing trade running the biggest loss first, then the next highest loss and so on until they get back to above 50% or have no open positions.
Application Date	<i>3 months after the day on which the legislative instrument is registered</i>	<ul style="list-style-type: none"> • We will be required to update our legal documents to reflect the change. • After the Application Date, we will need to spend time reviewing the current version of our client agreements and PDS to ensure that positions opened 3 months after commencement comply.

Condition 3. Negative balance protection		Feedback
Requirement	<i>The terms of a CFD offered to a retail client must limit the retail client's losses on CFD positions to the funds in that retail client's CFD trading account.</i>	<ul style="list-style-type: none"> • We consider this requirement to be detrimental to retail traders because it encourages risky trading strategies. Negative balance protection will effectively mean that the client's trading loss is limited to their initial deposit amount. • Negative balance protection will also inherently make risk management more difficult for Forex brokers because they are not able to forecast their total exposure. As a result, it will require Forex brokers to increase the level of capital required due to the uncertainty of client exposure. • It will also discourage brokers to hedge their flow because of the risk of the broker owing funds to the liquid provider and the client having defaulted due to this 'protection' ultimately leads to greater risks for clients who will be exposed to the capital risk of brokers. • EightCap does not have any "formal" negative balance protection in place (that means, we do not refer to it in any client agreement). However the commercial reality of recovering negative balances from retail clients is extremely low given the legal and reputational costs associated with doing so – we will usually reduce negative balances to nil on request.
Application Date	<i>20 business days after the day on which the legislative instrument is registered</i>	<ul style="list-style-type: none"> • We will be required to seek external counsel to update our legal documents to reflect the change and advise clients accordingly. The proposed application date is therefore unreasonable.

Condition 4. Prohibition on inducements		Feedback
Requirement	<p><i>A person must not, in the course of carrying on a business, give or offer a gift, rebate, trading credit or reward to a retail client or a prospective retail client as an inducement to open or fund a CFD trading account or trade CFDs.</i></p> <p><i>However, the prohibition would not cover information services or educational or research tools.</i></p>	<ul style="list-style-type: none"> • We believe this Condition is unreasonable and unfair as no other financial services provide are prohibited from providing the same kinds of inducements to clients. • Not providing these incentives to our clients is in fact disadvantaging our clients as their costs to trade will in turn increase. • The Condition requires ongoing monitoring and it would be impractical to assume control over distribution networks. We are concerned with the intended outcome ASIC is pursuing would be difficult to achieve because third party providers are not regulated by ASIC. • We are also concerned that the imposition of this Condition would lead to an increase in the number of third parties offering inducements without the protections afforded with Brokers advertising in line with ASIC regulatory guidelines. We suggest that the intended purpose of the Condition to reduce the number of clients being induced will not be achieved as inducements will be provided by third parties.
Application Date	<p><i>20 after the day on which the legislative instrument is registered business days</i></p>	<ul style="list-style-type: none"> • Eightcap will need to update its promotional material policies and monitor distribution networks. • We estimate the time to engage a marketing consultant to assist with amending Marketing policies and procedures will approximately 4-6 weeks with changes to marketing collateral taking an addition 2-4 weeks. • While Eightcap would monitor its distribution networks we would have to rely on third parties to amend their campaigns. • Therefore, we believe the 20-day application period to be unreasonable.

Condition 5. Risk warnings		Feedback
Requirement	<p><i>A CFD issuer must provide a prominent risk warning to retail clients and prospective retail clients on all account opening forms, PDSs, any trading platforms maintained by the CFD issuer and websites relating to CFD trading which, at a minimum:</i></p> <ul style="list-style-type: none"> <i>includes a warning on the complexity, risks and likelihood of losses; and</i> <i>discloses the percentage of the CFD issuer's retail clients' CFD trading accounts that made a loss over a 12-month period.</i> 	<ul style="list-style-type: none"> Unique to Australia, this Condition does not mirror any other regulator. We propose that it would be more suitable to impose a standard industry warning as opposed to broker specific warnings. We believe that brokers may use the warning as a marketing strategy and the warning may also distort the brokers exposure. Without standard weighting calculation requirements, the total loss incurred by clients may be represented as a misleading figure by brokers. Disclosing percentage of the CFD issuer's retail clients' CFD trading accounts that made a loss over a 12-month period will not accurately reflect losses as some brokers may have few clients but greater losses. By imposing these conditions clients may rely on this information solely when deciding which broker to trade with. Eightcap is already engaged in the practice of disclosing the complexity, risks and likelihood of losses and disclosure is already provided to our clients.
Application Date	<p><i>3 months after the day on which the legislative instrument is registered</i></p>	<ul style="list-style-type: none"> We will be required to seek external counsel to update our legal documents to reflect the change and advise clients accordingly. The application date is therefore unreasonable. We estimate that it will cost \$30,000 for external counsel to assist with this process. In addition, we estimate it will require \$20,000 in internal compliance resources to give effect to the proposed Condition. Marketing and Website development resources would also be required to be incurred – we estimate this to be approximately \$10,000.

Condition 6. Real-time disclosure of total position size		Feedback
Requirement	<i>A CFD issuer must provide real-time disclosure to a retail client, in any trading platforms maintained by the CFD issuer, of the retail client's total position size in monetary terms for all open CFD positions for the retail client's CFD trading account.</i>	<ul style="list-style-type: none"> As part of the onboarding process and ASIC's benchmark requirements Eightcap undertakes a client suitability questionnaire therefore we do not believe mandating the real-time disclosure of total position size will offer any additional benefit for clients. ASIC has suggested that retail clients do not have a clear idea of the total size of their positions. We reject this assessment as this has been based on 'surveillance activities' performed by ASIC however is not substantiated in the Consultation Paper. We submit that further evidence is required to support this Condition and it requires substantial technological implementation and development by the Broker to implement. The Metatrader Platform used by clients is an 'of the shelf product' that does not allow for bespoke changes. This trading platform is offered by approximately 80% of its Brokers. To overcome this we would need to build a 'plug in' however this could be removed from the platform at any time by the client as it is a plug and cannot be hardcoded in. We note this Condition has not been imposed by other jurisdictions and recommend that ASIC further understand the technology that underpins the industry and the limitations with the platform.
Application Date	<i>3 months after the day on which the legislative instrument is registered</i>	<ul style="list-style-type: none"> Given we are unsure if this is even possible to implement given the strict requirements of the Condition, we firmly believe that a 3 month application date is unreasonable.

Condition 7. Real-time disclosure of overnight funding costs		Feedback
Requirement	<i>If a CFD issuer charges a retail client funding costs for holding open CFD positions overnight, the CFD issuer must clearly and prominently disclose, in any trading platforms maintained by the CFD issuer, applicable overnight funding costs to the retail client, both as an annualised rate of interest and as an estimated cost expressed in the currency denomination of the CFD.</i>	<ul style="list-style-type: none"> • We are concerned with the anti-competition implications associated with mandating the disclosure of overnight funding rates given that we could be misrepresenting as an annualised rate what is in its very essence a short-term rate based on the interest rate differentials of the currencies involved at the time the swap rate is calculated. • In particular, the intent of ASIC to bring clarity to the calculation of the swap rate will in fact be distorted by another proxy calculation i.e. an annualised rate of interest which is not at all relevant for intraday or short term trading clients. Further, we suggest that the Metatrader trading platform already displays in a common notation being to a pip (4-decimal points) and point (5-decimal points) an overnight funding rate that is in the most relevant notation for clients. • This Condition being proposed by ASIC that has not been implemented in other jurisdictions and appears to show a lack of understanding of clients trading.
Application Date	<i>3 months after the day on which the legislative instrument is registered</i>	<ul style="list-style-type: none"> • We estimate the technological development to be 20-24 weeks.

Condition 8. Transparent pricing and execution		Feedback
Requirement	<p><i>A CFD issuer must maintain and make available on its website a CFD pricing methodology and a CFD execution policy. The CFD pricing methodology must explain how the CFD issuer determines its CFD prices, including:</i></p> <ul style="list-style-type: none"> <i>• how it uses independent and externally verifiable price sources;</i> <i>• how it applies any spread or mark-up; and any circumstances under which its CFD prices will vary from the methodology. The CFD execution policy must explain how the CFD issuer deals with clients' offers to trade CFDs and effects CFD trades.</i> 	<p>We do not agree with this Condition. We believe that Transparent pricing and execution requirements are adequately covered in RG 168 Disclosure: Product Disclosure Statements (and other disclosure obligations). Our hedging policy is currently available on request.</p> <p>Clients are already provided with a significant amount of information in the required disclosure documents. The Client is required to read and agree to Eightcap 's PDS, FSG, client agreement and risk notice which is currently more than 43 pages. Other brokers have these documents well over 100 pages. In the insurance industry its noted that 80% of clients do not even read the PDS as discussed in the below article: https://www.smh.com.au/business/consumer-affairs/majority-of-consumers-dont-read-product-disclosure-statement-before-buying-insurance-20170228-gumuyz.html).</p>
Application Date	<i>3 months after the day on which the legislative instrument is registered</i>	Despite our objections to this condition we believe 3 months after the day on which the legislative instrument is registered is a reasonable period for implementation.