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OTC Intermediary Compliance
Market Supervision
Australian Securities and Investment Commission
Level 7, 120 Collins Street
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Comments on ASIC Consultation paper (CP 322)

First Prudential Markets Pty Ltd **(FP Markets)** is a leading broker that specialises in Contracts for Difference and Foreign exchange derivatives for retail clients and has held an Australian Financial Services License since 2005. FP Markets is committed to our customer's satisfaction and providing financial services in accordance with all financial services regulations.

Executive Summary

FP Markets presents this submission with the purpose of addressing issues raised by ASIC in the CP 322. FP Markets is supportive of regulatory improvements that better protect clients. However, we believe that it is unlikely that ASIC's initiatives will achieve their intended outcomes.

FP Markets is a member of the Australian CFD and FX Association which has made a submission and we are in complete agreement with the contents in the Association's submission. As such, this submission is focused on providing additional feedback rather than duplication of the content provided by the Australian CFD and FX Association.

We thank ASIC for the opportunity to provide submissions on CP 322.

Additional Feedback

1. We do not dispute that some retail clients have suffered detriment (financial loss) as a result of trading Contracts for Difference (CFD), however, all investment products and trading activities have a certain level of risk. The CP 322 does not recognize those clients who have traded profitably nor those clients who have used these products to mitigate risk.

   We have many clients who use our products as a very efficient tool to hedge risk and perform short term asset re-allocation. By limiting the availability of these products without reasonable and considered levels of gearing or margining will directly impact these clients as it will increase their risk profile and be detrimental, which is contrary to ASIC's objectives.

   Furthermore, there are a number of clients that have traded profitably with us for many years and such clients will be denied their right to continue to make their current income should the proposed amendments come into effect. It also does not consider these risks in light of other trading activities, such as equity day trading.

2. In principle we are supportive of the negative balance protection. However, we note that if there is no opt-out option we will have to materially restrict the number of equity CFDs offered to our clients. By imposing restrictions on trading instruments and trading opportunities could be seen as adding detriment to a client.

3. The number of complaints should be considered relative to the size of the industry. When considering that there have been 4,000 complaints over around 3,500 entities, it should also be noted in the context of 1,000,000 trading clients. We note that the data around complaints does not consider that complaints are concentrated with a few providers only and are not indicative of an industry-wide consensus. Also, a small group of websites are instructing clients to make formal complaints as an attempted strategy to have funds returned after placing a legitimate losing trade. We believe that currently, ASIC has extensive regulatory powers which enable it to prosecute and punish those who do not comply with the regulations.

4. Australia is currently a venue of choice for traders as indicated by the growth of the industry here. In the event that proposals make ASIC regulated providers unattractive and uncommercial with client demands, not only will Australia lose the economic benefits, they will further lose jurisdictional ability to ensure firms are acting fairly. We have Australian clients who have already stated that they intend to trade with an overseas entity located in a foreign jurisdiction in the event that they cannot operate their trading strategies in Australia, effectively negating the proposals and potentially putting these clients at greater risk.

5. Recently, ASIC's focus was on counterparty risk and client money protection. Since the implementation of ASIC's enhanced client money protection reforms, there have been 2 further collapses (Halifax Investment Services Pty Ltd and Berndale Capital Securities Pty Ltd) resulting in loss of client monies. The relevance is that despite client concerns about counterparty risks, they will be required to place more capital with providers, in the event that clients are forced to place additional margin, due to lower leverage offered.

6. Cost and Timing: In our opinion, the time frame for the commencement of the order is inadequate to ensure the proper updating of compliance procedures and the implementation of new policies which will be required to address the regulatory changes. More time will be required as these new conditions require changes to software, which will require coordination of third-party providers such as IT specialists. Similarly, the instrument will fall within the definition of the financial services laws. Therefore, CFD issuers will need to update and create new AFSL compliance procedures, terms and conditions and disclosure documents to reflect these changes. The proposed timeframes do not provide sufficient time for this to be implemented properly. The consequences of non-compliance are substantial, including civil penalties and administrative action for a breach of an AFS license. CFD issuers should be given an appropriate amount of time to fully implement and comply with the changes.

   Further, in the event that the order comes into effect, clients with open positions will need time to either reduce their exposure or find additional capital to hold their open positions. It is likely that the reduced leverage ratios will alter clients' trading strategies. Clients should be provided adequate time to seek advice and consider how the changes will impact them. In order to overcome these constraints, FP Markets proposes that the conditions identified within the CP 322 as having a time period of 20 days to be complied with be extended to six months and those conditions identified as having a three month period to be complied with be extended to twelve months.

7. In the event that ASIC decided to move forward with their proposal, we would be very supportive of an experienced investor carveout. This would enable clients that do have sufficient knowledge, to be able to continue trading under ASIC regulation without forcing them to either discontinue trading, materially increase their capital needs or look for offshore providers that can accommodate their trading requirements.

We propose that Experienced investors have the following leverage restrictions:[1]

- Major currency pairs* - 100:1
- Non-major currency pairs, gold and equity indices - 50:1
- Commodities other than gold - 30:1
- Individual equities and other reference values - 20:1
- Cryptocurrency assets - 5:1

*Major currency pairs are any products whose base and quoted currency are made of the following currencies: AUD, USD, EUR, JPY, GBP, CAD or CHF.

8. Closeout logistics**:** We agree in principle to a proposal regarding closing out one or more of a retail client's open CFD position if the funds in their account fall to less than 50% of their total initial margin, however we note there are practical issues with the implementation of this. Certain systems and trading platforms such as IRESS do not offer an automated stop out system and we believe that some consideration should be made to the human element of this process which may require up to 10 minutes to close out the trade.

   When liquidating equity positions, market liquidity should be taken into consideration. Forcing liquidation that results in a rapidly liquidated into an illiquid market will, in many instances result in severe detriment to clients and would have the effect of increasing the loss. We request that ASIC consider this important point with respect to DMA equity CFDs.

   Further to this, retail investors may inform the CFD provider that funds have been sent, however, these funds will not be reflected in their account. In such circumstances, we would like to ensure that some flexibility is allowed with temporary exclusions. Retail investors are likely to view the implementation of stop out of positions without the chance to meet the margin call as significantly detrimental to their interests.

9. Negative balance protection and DMA trading: ASIC has not distinguished between the different pricing and execution models of CFD providers, in particular, the Direct Market Access (DMA) CFD model. This requirement is not suitable for a DMA provider like FP Markets where the underlying instrument is hedged on a registered exchange such as the ASX. Such a proposal will have a significant financial impact on DMA CFD providers and encourage them to move away from the DMA CFD model towards greater internalising of client orders and thus increasing the conflict of interest held between the CFD provider and the client. We do not agree with the proposed requirement by ASIC on limiting a retail client's loss to funds in their trading account for a DMA CFD model. Negative balance protection should be exempt for the DMA CFD model as brokers in all circumstances will hold the underlying equity position. We note that stock brokers are able to pursue payment from their clients as they hold the underlying equity and believe that a DMA CFD broker should also be able to pursue payment in the same way.

[1] As defined in the submission made by the CFD & FX Association which we are a member.

Conclusion

In summary, we support ASIC's agenda to better protect retail clients and address concerns around investor detriment. However, we urge ASIC to consider the unintended consequences of implementing proposals outlined in CP 322. In our view, implementation of all proposals in their current format will add to client detriment in many circumstances, particularly for experienced traders, for the following reasons:

1. Hedging capabilities will be reduced due to the increased capital requirements – as a consequence of lower leverage requirements
2. A reduced number of equity CFDs will be available as offering smaller stocks will no longer be viable – as a consequence negative balance protection
3. Forced liquidation into illiquid equity markets will result in additional loss to clients – as a consequence of requiring clients to hold a minimum of 50% of required margin
4. Clients will be liquidated in some circumstances for reasons outside their control, such as time taken for banks to transfer funds
5. Clients will be forced to face increased counterparty risks as additional capital will be required to be held with CFD providers – as a consequence of lower leverage

Further negative outcomes are likely to include:

6. Increased complaints from clients who are contracted with off-shore entities and ASIC will no longer have the jurisdiction to address client concerns
7. Australia will lose a large industry which contributes significantly to the Australian economy
8. Considerable costs of implementation for Australian businesses.

In order to avoid unintended consequences which are likely to be detrimental to retail clients, we respectfully request that ASIC consider an experienced investor carveout so that experienced clients who are of the view that the proposals presented in CP322 will be to their detriment, will have an ability to continue trading under existing terms with an ASIC regulated provider. We believe that this will enable a more appropriate balance between retail client detriment and consumer choice to be achieved.

We appreciate the opportunity given to us to provide feedback and we would welcome any opportunity to further discuss any aspect of this submission.

Yours sincerely

Matthew Murphie

Managing Director

First Prudential Markets Pty Ltd