25 January 2020

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

OTC Intermediary Compliance

Market Supervision

Australian Securities and Investment Commission

Melbourne VIC 3000

Re: Submission in response to Consultation Paper 322 – Product intervention: OTC binary options and CFDs

We appreciate the opportunity to make a submission in response to ASIC Consultation Paper 322 **(CP 322).**

1. **Introduction**

1.1. We write to you on behalf of FXCM Australia Pty. Limited ("FXCM", "We" or "the Company") ACN: 121934432 and AFSL Holder: 309763. We are a leading provider of online CFD Trading with over 20 years of experience in the industry.

1.2. We provide this submission in our own right and not in co-operation with any other CFD provider. We are authorized, under our AFSL, to provide general advice, deal in, and make a market, in relation to derivatives and FX contracts to retail and wholesale clients.

1.3. This is our second response in relation to consultation on this topic. We are informed that ASIC is still considering alternatives to its proposed measures that will achieve the same level of protection for retail clients, despite consultation ending on the 1st October 2019. To this end, new information has come to light that we feel we should notify ASIC of, before a final decision is made.

2. **Our concerns with ASIC's proposed order**

2.1. Generally speaking, FXCM is not opposed to the making of a product intervention order in relation to the CFDs industry. We believe that some of the proposed measures provided in the draft legislative instrument are an excellent method of deterring the poor conduct of a select few CFD brokers and improving retail client protections. For instance, FXCM is not opposed to the measures regarding negative balance protections and execution transparency.

2.2. However, in some aspects, FXCM is concerned that the draft measures may not achieve the outcome that ASIC seeks. To this end, we wish to highlight the following:

(1) Leverage ratio limits should be increased as they are far more restrictive than what is necessary to protect retail clients, especially in light of the suite of other protections proposed. We agree that leverage restrictions should be imposed, but not to the overly restrictive extent that ASIC provides in CP 322.

(2) We agree that ASIC is right to recognize and respond to the predatory impact that incentives can have on vulnerable retail clients. However, we respectfully submit that ASIC is generalizing the population of retail clients who trade CFDs when imposing the prohibition on inducements. Some clients are sophisticated and experienced enough to understand and appreciate the risks of trading in CFDs and the offer of a rebate, trading credit or reward does not change this. The prohibition on inducements across the board puts CFD issuers at a competitive disadvantage against other financial firms- in our ability to retain our most valuable clients.

(3) The complexities and ongoing costs for CFD issuers in relation to calculating and providing risk warnings far outweigh the benefits of providing these risk warnings to retail clients. We respectfully submit that ASIC is overestimating the deterrence value of issuer-specific risk warnings to retail clients, especially considering the vast array of disclosures, disclaimers and warnings already enforceable by Australian regulation.

(4) We agree with ASIC that overnight funding costs (such as rollover) should be disclosed to retail clients, but not additionally as an annualized rate. We believe that the provision of this measure would enhance obscurity of roll-over costs rather than making them more transparent.

(5) The industry requires more time than what ASIC is proposing to implement the conditions of the final order, when that order is made.

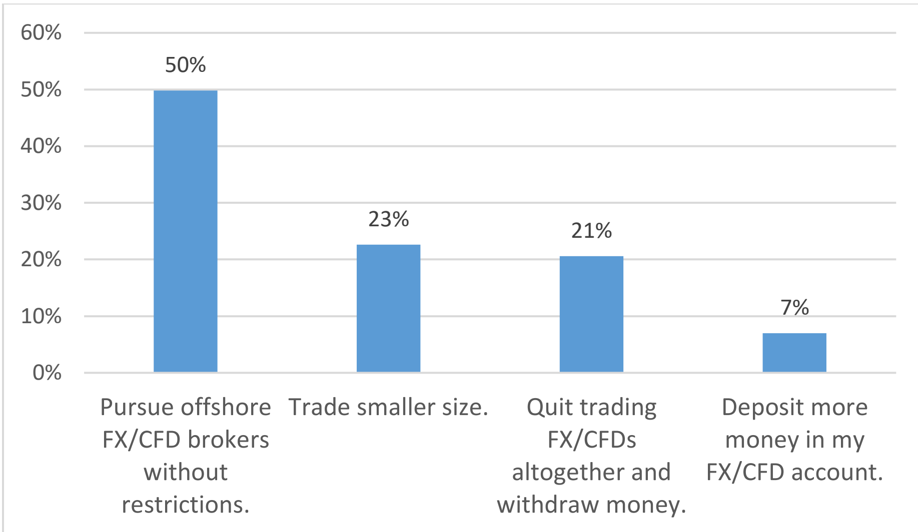
F1Q1 Do you agree with our proposal to make a market-wide product intervention order which imposes Conditions 1–8 (set out in Table 5) on the issue and distribution of CFDs to retail clients? If not, why not? If you disagree that CFDs have resulted in, and are likely in future to result in, significant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

<u>**Leverage Restrictions**</u>

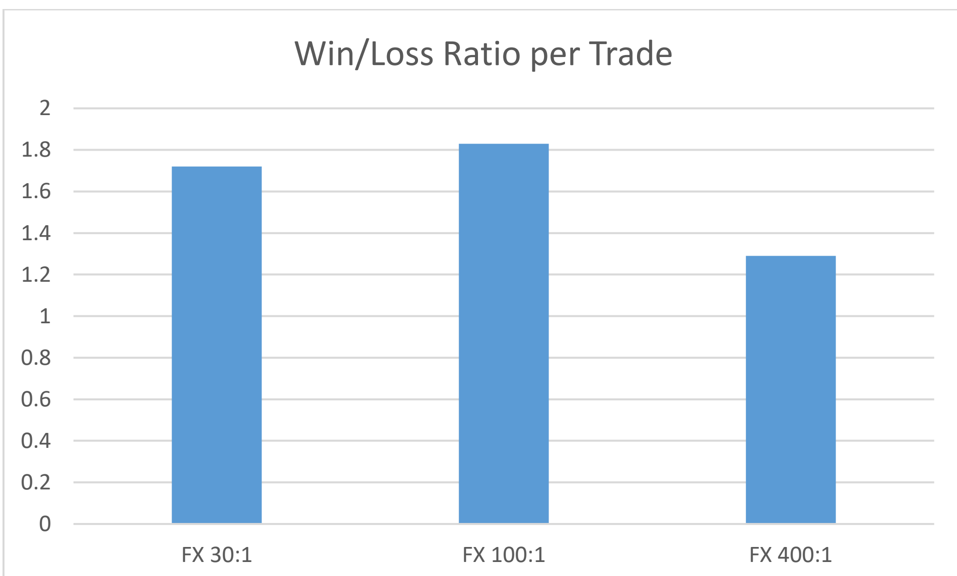
3. We agree that leverage restrictions are necessary to protect retail clients from detriment. However, we feel that the draft order in its current form, goes further than reasonably necessary and may not achieve ASIC's desired outcome.

3.1. Moreover, we fear that such restrictive measures will enhance opportunities for regulatory arbitrage by pushing retail clients into unregulated jurisdictions overseas.

To this end, we submit the results of a survey completed by 1900 of FXCM's clients before the introduction of the ESMA measures. 50% of retail clients stated they would pursue offshore brokers if the measures were introduced.



3.2. Similarly, FXCM conducted a study on the effect of different leverage profiles of FX CFDs on the average win/loss ratios of the retail client population. The sample was considered for trading activity of over 50 000 clients over the calendar year of 2019. The results are depicted in the chart below:



3.3. The above results show that leverage restrictions do not have a meaningful impact on win/loss ratios between retail clients trading on 100:1 leverage or 30:1 leverage. On the other hand, we submit that a higher leverage of 400:1 does indeed have a marked negative impact on win/loss ratios of retail clients per trade and ASIC are right to respond in relation to the provision of exceedingly high leverage limits like these.

3.4. However, we note that the proposed leverage restrictions denoted in the draft legislative instrument are far too restrictive and a more moderate approach is warranted. Leverage limits of 100:1 on FX CFDs are more reasonable and as can be seen from the data, they infact produce higher win/loss ratios per trade than retail clients trading on 30:1 leverage.

3.5. Moreover, a leverage restriction limit of 100:1 would do more to appease retail clients who otherwise are likely to pursue unregulated issuers overseas for unrestricted leverage options. We envisage that this will lead to increasingly poor outcomes for retail clients and is contrary to the ASIC's desired outcome.

3.6. We respectfully submit that a less severe approach to leverage restrictions would successfully balance the improvement of retail client protections and client regulatory arbitrage. We understand that both of these considerations are of utmost importance to ASIC, and our proposal for an alternative will satisfy both concerns.

Prohibition on Inducements

4. We agree that ASIC is right to use its product intervention power to address inducements aimed at soliciting vulnerable retail clients. However, in saying this, we believe ASIC is generalizing the population of retail clients that trade CFDs. Some clients are sophisticated and experienced enough to understand and appreciate the risks of trading in CFDs and the offer of a trading credit, discount or rebate doesn't change their ability to assess the nature of their investment.

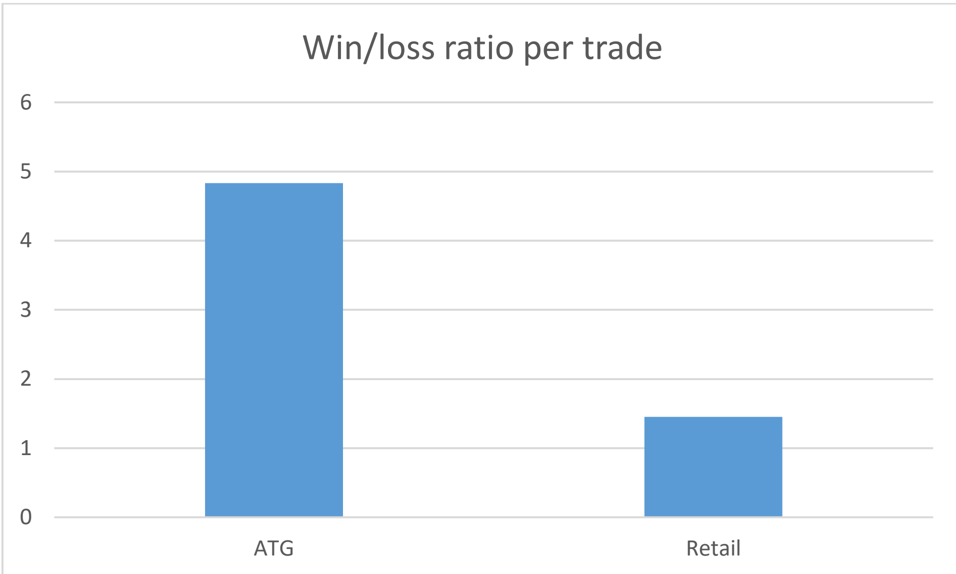
4.1. Inducements are not an inappropriate marketing strategy in attracting retail clients who consistently trade at a high-volume in a sustainable fashion.

4.2. To be restricted from offering trading credits, rewards, discounts and rebates to experienced, high-value investors puts CFD issuers at a competitive disadvantage in comparison to other financial firms and their own respective high-value clients.

4.3. We respectfully submit that in relation to this said group of clients- rewards, rebates, discounts and credits are less an inducement and more an appreciation for our high-value clients, whereby their costs of trading are reduced.

4.4. FXCM clients that sustainably trade at a pre-determined high volume each month are invited to a select group called the Active Trader Group ("ATG"). These clients make up less than 1% of FXCM's client base and benefit from reduced costs of trading as a reward for their high-value.

The below data, extracted from FXCM's client pool, showcases that our Active Trader Group ("ATG") clients consistently have a higher win/loss ratio on each trade overall than the average retail client. These clients make up less than 1% of FXCM's overall client pool.



4.5. As can be seen from the data above, ATG clients have a three times higher win/loss ratio per trade than the average retail client. In this way, they demonstrate a superior ability to assess risks and trade more profitably in CFDs and thus, are unlikely to be swayed by the offer of a rebate, discount, trading credit or reward.

4.6. To this end, we propose that ASIC allows CFD issuers to continue to provide inducements to certain classes of retail clients that demonstrate a superior ability to assess risk and trade sustainably. An example of such a test, could be the following:

'Where retail clients trade a notional value of $50 million AUD per month in a sustainable fashion, they will not be subject to the prohibition on inducements.'

FXCM currently uses the test above for the purposes of inviting clients to ATG status.

4.7. In totality, FXCM agrees with ASIC's proposal to prohibit inducements to retail clients, especially those retail clients that are vulnerable. However, we feel that inducements are necessary for CFD issuers to maintain the satisfaction of their high-value clients. To not do so would unduly restrict the competitiveness of CFD issuers in retaining their best clients.

4.8. As stated, these clients have a demonstrated ability of assessing risks and trading profitably. These clients are not vulnerable and the offer of an inducement to these clients is not predatory. It is instead an appreciation for being a high value client, whereby their costs of trading are reduced.

4.9. As stated, the test above would encompass less than 1% of the retail client pool of CFD issuers and it is necessary for ASIC to make this delineation to promote the interests of high-value traders whilst balancing the need for greater retail client protections.

Overnight Funding Costs

5. We agree that real-time updates of overnight funding costs should be disclosed to retail clients by all CFD issuers on their platforms. However, we do not agree that these funding costs should be depicted by way of annualized rate (whether it be fixed or estimated).

5.1. Estimated and fixed annualized rates of rollover would only serve to confuse clients and enhance the obscurity of rollover disclosures. To this end, it would defeat the purpose that ASIC is trying to achieve. It is unlikely that the average retail client will leave their positions open for a year or more, thus, the client benefits of such a measure would be contentious.

5.2. Moreover, the changes ASIC are seeking would require further Trading Platform development work and co-operation with third party platform providers. When balanced against the perceived benefit this would have for retail clients, introducing this measure seems unreasonable.

5.3. It is our position that retail clients are best served by a depiction of a daily rate of rollover per minimum lot size for each CFD offered. This will provide them with an accurate snapshot of the rollover costs or credits that will be incurred at the close of trading each day.

5.4. We respectfully submit, that this course of action would be preferable for both derivatives issuers and their retail clients.

Risk Warnings

6. **F1Q3 (Risk warnings): 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?**

6.1. We do not agree with proposals to provide further risk warnings.

6.2. FXCM and other CFD issuers are already required, by law, to provide an array of disclosures, disclaimers and risk warnings to retail clients, in account opening forms, marketing materials, disclosure documents and on our website. We question whether the decision to provide further risk warnings would provide any real benefit to retail clients.

6.3. ASIC recently issued a report (REP 632) explaining that disclosures are often less effective than expected, or even wholly ineffective in influencing consumer behavior. As stated in the report, warnings are often ignored, overlooked, misunderstood, or misremembered by retail clients. In some situations, they may even backfire, as a result of the proliferation of warnings in the day-to-day lives of retail clients.

6.4. When this lack of benefit is coupled with the time and cost of implementation in terms of legal advice, internal resources, technological developments, as well as calculating and disclosing these issuer-specific risk warnings, we feel that these further risk warnings will not achieve their intended goal.

6.5. FXCM and many other CFD issuers rely on third party platform providers for the provision of our services. It will be difficult to negotiate the proviso of these risk warnings on platforms where the CFD issuer is not the proprietary owner. In any case, the development work in providing these risk warnings, even on our own proprietary platforms, will be increasingly time consuming and resource-straining.

6.6. The resolve of retail clients can in some situations be so strong that any risk warnings, no matter how prominent or striking, will not deter them from engaging in financial products that may not be suitable for them. We feel that the Condition 8 of CP 322 will better serve the purpose of ensuring retail clients observe and understand the risks of trading in CFDs.

<u>Delayed Commencement</u>

7. **F1Q5 (Delayed Commencement): 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?**

7.1. In short, no. We feel that more time is required to effectively implement the order.

7.2. The main justifications for this are that the changes require a comprehensive overhaul of trading platforms, disclosure documents, website materials and internal policy and procedures.

7.3. Similarly, we must ensure that we continue to provide an adequate level of service to our existing retail clients whilst our technological, compliance and development resources are being utilized to implement the final orders handed down by ASIC.

7.4. Given the heavy penalties imposed under the Corporations Act for non-compliance with AFSL requirements, it is imperative that CFD issuers are given an adequate amount of time to introduce the requirements, whether or not they deviate from the current proposed order.

7.5. We respectfully submit that a more appropriate period for delayed commencement is as follows:

(1) 3 months from the effectiveness of the Order for Conditions 1, 3, 4 and 5 (excluding platform risk warnings); originally 20 business days.

(2) 6 months from the effectiveness of the Order for Conditions 2, 6, 7 and 8 (including platform risk warnings); originally 3 months.

Concluding Comments

If you have any questions regarding this submission, please do not hesitate to contact Kaan Yuksel at [redacted]

Yours sincerely,

Kaan Yuksel

Australia Compliance

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