FAIR MARKETS

29 November 2021

Retail Complex Products and Investor Protection
Market Supervision
Australian Securities and Investments Commission
GPO Box 9827
Brisbane QLD 4001

By email only: market.supervision.OTC@asic.gov.au

Dear ASIC,

Consultation Paper 348: Extension of the CFD Product Intervention Order

Fairmarkets Trading Pty Ltd ("Fairmarkets" or the "Company") welcomes the opportunity to comment on ASIC's Consultation Paper 348: Extension of CFD Product Intervention Order" (the "Consultation Paper").

With regards to the questions set out in the Consultation Paper, we respond as follows:

> **Do you agree with our proposal to extend the CFD Order so that it would remain in force until revoked? If not, why not? Should the CFD Order instead be extended for a set period of three or five years until 1 April 2031 (when the Product Intervention Order sunsets)?**

Fairmarkets do not agree with the proposal to extend the CFD Order in relation to leverage ratios and incentives. With regard to the margin close out protection and negative balance protection, Fairmarkets would, in principle be supportive of this measure remaining in force.

The desire for leverage is investor driven and not issuer driven. This is why foreign retail investors trading in Australia dropped by 46% upon the leverage restrictions being imposed and the number of Australian wholesale customers increased by 839%. As outlined below, it is Fairmarkets' view that consumer detriment has occurred as a result of the CFD Order.

In your view, has the CFD Order been effective to date in reducing the risk of significant detriment to retail of significant detriment to retail clients? Please provide evidence and data in support of your view where possible.

The CFD Order has not been successful in reducing the overall risk of significant detriment. This can be clearly drawn-out of ASIC's own figures.

Table 6: Average profits and losses of active retail client accounts

Time period	Average losses	Average profits
1 Apr 2020 – 30 Jun 2020	$2,761	$2,251
1 Jul 2020 – 30 Sep 2020	$2,536	$1,750
1 Oct 2020 – 31 Dec 2020	$1,962	$2,276
1 Jan 2021 – 28 Mar 2021	$1,922	$1,950
29 Mar 2021 – 30 Jun 2021	$986	$867

Table 6 of the Consultation Paper provides the average profits and losses of active retail clients. In the periods of 1 Oct 2020-31 Dec 2020 and 1 Jan 2021 – 28 Mar 2021, before the CFD Order was enacted average profits were greater than average losses. Average losses between 1 April 2020 – 30 Sep 2020 were greater than average profits. This is no surprise as these months were characterised by high volatility and uncertainty due to the COVID-19 pandemic. Including Dow futures falling more than 1,000 points and Standard & Poor's 500 futures dropping 5%, triggering a circuit breaker. Locally, the S&P/ASX 200 set a one-day record fall of 9.7% and collapsed 30% from its 20 February 2020 peak.

While difficult to speculate it would be open to conclude that had the CFD Order not been in place from 29 March, that consumers would have had average profits greater than average loss given similar trading conditions in the previous to periods.

During these periods there were 221,506 profit-making accounts (1 October 2020- 31 December 2020) and 188,279 (1 January 2021 – 28 March 2021). For the period 29 March 2021 – 30 June 2021 there were 178,713. A not insignificant reduction which is more than likely causally linked to the CFD Order.

Table 12: Changes in active client population types

Time period	Retail Australian	Retail foreign	Wholesale Australian	Wholesale foreign
1 Apr 2020 – 30 Jun 2020	100	100	100	100
1 Jul 2020 – 30 Sep 2020	106	101	140	106
1 Oct 2020 – 31 Dec 2020	112	97	189	198
1 Jan 2021 – 28 Mar 2021	140	87	531	786
29 Mar 2021 – 30 Jun 2021	124	54	839	1190

Note: This is the data shown in Figure 8.

Table 12 illustrates another prime example of well-intentioned regulation producing negative externalities. The number of Australian wholesale clients from 1 April through to the period of the regulation increased by 8.4 times. As the CFD Order does not apply to wholesale investors, it would not be a stretch to surmise that clients wanting greater leverage are opting for wholesale accounts rather than opening lower leverage retail accounts. This has produced a suboptimal outcome for clients who are now not afforded protections such as disclosure documents and access to AFCA in order to trade in financial products which are structured to their needs and wants.

Similarly, the trend in foreign retail investors presents a scenario of consumer detriment. From the period ended 30 June 2020 to the period when the CFD Order was introduced the number of Foreign Retail Investors dropped by 46%. The desire for higher leverage has driven clients to entities which are possibly unregulated or regulated in jurisdictions which do not have the protections in Australia which makes our jurisdiction highly regarded. When ESMA first introduced leverage limits, it was widely reported that there was a mass exodus of retail clients from European based brokers to offshore brokers in Australia. This was confirmed by Consultation Paper 322 – where it was reported that the number of clients between 2017 and 2019 increased by 121%.[1] It is apparent that consumers with a drive to invest in higher leveraged products have invested in other jurisdictions which are unlikely to have a regulator as competent as ASIC to stamp out undesirable behaviour. In this way, ASIC has not removed consumer detriment but rather moved client losses to a jurisdiction where clients are not afforded the protections which they ought to be.

For CFD issuers and distributors, if the CFD Order is not extended, would you change your business model and what costs would that incur?

Fairmarkets would introduce higher leverage in line with client demand. Other conditions of the CFD Order would not be reverted. Fairmarkets would look at the incentive prohibition on

[1] ASIC 'Consultation Paper 322: Product intervention: OTC binary options and CFDs'.

an individual level to ensure that any and all promotional campaigns are in line with the companies values and regulatory requirements including the Design and Distribution Obligations.

For CFD issuers and distributors, what impact has the CFD Order had on your business? What ongoing impact to your business would you expect if the CFD Order is extended?

The CFD Order has had a significant impact on our business. Total notional value within the industry amounted to $5.5 trillion between 1 July 2020 and 30 September 2020. Between 29 March and 30 June 2021, it was $1.7 trillion. This is a reduction of trading across the industry of -69%.

If the CFD Order is extended, what annual ongoing costs do you anticipate you would incur? What other costs do you anticipate you would incur?

We anticipate the ongoing costs for complying with the CFD Order is ~$3,000 noting that the staff resourcing is a fixed cost and these resources would have still been incurred albeit their resources are deployed for ensuring compliance under the CFD Order.

What effects (if any) do you consider the CFD Order has had on competition in the financial system? What effects are likely if the CFD Order is Extended?

The CFD Order has significant and unintended consequences on the financial system. In Consultation Paper 322 it was stated that there were $2.9 billion in Client Funds. CP 348 states that as of 31 July 2021 this figure is $2.21 billion. The deposit multiplier is a well-accepted economic doctrine which describes the phenomenon of how a bank is able to lend each dollar of its deposits into the economy at a rate of 1/ (reserve ratio). Using the bank liquid reserves to bank asset ratio of 4.2536% - the deposit ratio in Australia for 2020 was 23 times. This represents a 15.87 billion leakage to the Australian economy. On the more conservative multiplier of seven (7) times, this still represents $4.83 billion not circulating in the Australian economy.

As client deposits are a leading indicator for volume, over the long term, we could assume a reduction in line with trading of 69% in client deposits – this represents ~$2 billion less in Australian Deposit-taking Institutions. Using the traditional formula for the deposit multiplier this would represent $46 billion which was not able to be utilised by banks to lend to small businesses, first home buyers and infrastructure companies. Even taking a more conservative assumption of a multiplier of 7 times and a reduction in deposits of $1 billion – this would represent a seven billion leakage from the Australian economy.

The CFD Order is a significant deviation from the Commonwealth Government's aims within both the Johnson Report[2] and the Low report[3] of becoming the Next Global Financial Centre. Australia was the world leaders in CFDs before the CFD Order accounting for 17% of global volume. The CFD Order has ensured that Australia is no longer number one. It is unclear whether the CFD Order impacted Sydney and Melbourne dropping by seven and six rankings in the Global Financial Centres Index.

Conclusion

We trust this letter has been insightful. Should you have any queries, do not hesitate to contact me via email on [redacted] or alternatively via mobile on [redacted]

Yours sincerely,

[redacted]

JAMES O'NEILL
EXECUTIVE DIRECTOR
FAIRMARKETS TRADING PTY LTD

[2] Johnson 'Australia as a Financial Centre: Building on our Strengths – Report by the Australian Financial Centre Forum' (2009).

[3] Low et alia 'Australia as a Financial & Technology Centre Advisory Group (AFTCAG) Report' (January 2021) < https://assets.website-files.com/6080bc3bbbffd3f769ae5d7b/6080bc3bbbffd37ea5ae5ee3_AFTCAG%20Report%20-%2001.02.21%20-%20(WEB)-2.pdf>