ASIC
Australian Securities & Investments Commission

Higher risk offerings to retail investors

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Key Messages

ASIC is observing that neo-brokers are transferring risk to retail clients who may not understand the nature and extent of the risks. This trend is being driven by a slowing market. This is putting pressure on retail brokers, especially newer entrants with low margin, high turnover business models to look for higher risk products and services to supplement their revenue. Examples include is a proposal to offer securities lending to retail clients, brokers expanding into crypto and offers of leverage.

These offerings are often bundled with other offerings with claims of zero or low headline brokerage rates, which masks the true costs and risks.

There is also a heightened risk of failure among market participants and newer "neo" brokers. ASIC's primary focus is protection of client money/assets and market integrity. We have disrupted the most concerning offerings, issued public warnings, and raised consumer awareness of the risks. We will continue to intervene if we see offers to retail investors that are unfair, inappropriate or result in poor outcomes.

Background

With the onset of the pandemic, there was a significant influx of new retail investors into markets. There was a commensurate growth of new neo brokers to meet this demand.

Retail investor activity continues to remain elevated above pre-pandemic levels despite a slowdown over the past few months. The proportion of retail turnover in September 2022 was 11.9%, down from 14.1% in the previous month and 14.3% compared to a year earlier. Retail account openings also continue to decline, making this the fourth consecutive month that the daily average account growth has been lower than the pre-pandemic period.

With the slowing market, some brokers are operating at a loss and are at risk of failure. There is a concentration of execution and clearing and settlements brokers servicing neo brokers. If one fails, this may significantly disrupt the ability of many retail clients to trade securities until alternative arrangements are put in place. There are also limitations to protection from the National Guarantee Fund with some newer business models.

ASIC Action

Some neo brokers are pursuing alternative revenue sources that transfer greater risk to clients. We are seeking to mitigate these risks and disrupt activity that may harm many retail investors, including:

- Staying abreast of developments by constantly monitoring the market of both new entrants, changes by existing operators and development in offshore markets. We are engaging with providers to understand new product features and risks and considering how the financial services laws apply.

- This intelligence enables us to intervene early to disrupt or set expectations before harmful practices become entrenched in our market. For example, new rules which took effect in June 2022 to close a regulatory gap with our payment for order flow (PFOF) prohibition in the Market Integrity Rules. This proactive measure was in response to evolving market practices and increasing scrutiny of potential conflicts of interest associated with PFOF in other jurisdictions.
- Using public warnings to brokers to be careful about or reconsider offering high-risk products and services to retail investors, such as securities lending, crypto-assets and offers of 'zero' or 'low-cost' brokerage - where the true cost is masked: 22-239MR ASIC warning brokers considering high-risk offers to retail investors was released in August 2022.
- Increasing our supervision of high impact providers. A key focus has been on how client money and assets are being protected and how these are disclosed to investors.
- Conducting a review of digital engagement practices to consider if apps and marketing strategies are encouraging gambling like behaviour in trading (e.g. free shares and lottery or gaming features). This may encourage excessive trading or risk taking by retail investors. We are considering how to educate investors and drive product developers' compliance with disclosure and marketing requirements. We are also collaborating with international peers.
- Implementing a multi-pronged strategy which is disrupting 'pump and dump' activity in small-cap ASX-listed companies on social media platforms like Telegram, including early identification, trading halts and enforcement activity.
- Disrupting the provision of potentially unlicensed conduct and conflicted advice by financial influencers following the release of Information Sheet 269 Discussion financial services and products online in March 2022.

We continue to engage with brokers and other providers to understand risks to retail clients, regulatory requirements, and disclosures. Examples include:

[redacted] s 37(1)(a)

Many of these offerings are not subject to the design and distribution obligations (DDO), which can restrict our ability to seek appropriate regulatory outcomes for retail investors. Instead, we may rely on other provisions of the financial services laws (e.g. the general licensee obligations and the misleading or deceptive conduct provisions in the Corporations Act and ASIC Act).

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[redacted] s 37(1)(a), s 37(2)(b), s 47C, s 47E (d)

[redacted] s 37(1)(b)