6th December 2021

Retail Complex Products and Investor Protection Market Supervision
Australian Securities and Investments Commission ("**ASIC**")
GPO Box 9827
Brisbane QLD 4001

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

Dear Retail Complex Products and Investor Protection Market Supervision Team,

Re: ASIC Consultation Paper 348 Extension of the CFD product intervention order ("CP348")

We refer to your published Consultation Paper dated 18th October 2021, which sets out ASIC's findings on the impact of the ASIC Product Intervention Order ("**CFD Order**") imposed conditions on the issue and distribution of contracts-for-difference ("**CFDs**") to retail clients, and outlines ASIC's proposal to extend the CFD Order.

International Capital Markets Pty Ltd (**"we", "our"** or the **"Company"**) wishes to provide a formal submission to Consultation Paper 348 (**"CP348"**) and share the Company's reasoning and position on the proposed extension of the CFD Order.

Response to CP348 Questions

D1Q1 - 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 CFD Order sunsets)?

We do not believe the CFD Order should be extended for any time period. In support of this view, we have summarised our reasons as follows:

The leverage restriction imposed by the CFD Order has fundamentally changed CFD Products, making them no longer fit for purpose for experienced retail clients, especially for high-volume, speculative traders that our products are most suitable for. Due to this, we have experienced a dramatic drop in active client number since the CFD Order took effect on 29th March 2021.

In our view, we believe the CFD Order will not have a material effect in reducing harm for retail investors. This is further detailed below in 'D1Q2'.

The CFD Order is no longer necessary after the introduction of the Design and Distribution Obligations (**DDO**) and stronger Anti-Hawking restrictions. We believe these measures adequately protect retail clients from dealing in products not suitable to them and inappropriate inducement practices.

Whilst we support initiatives that improve the standards and quality of financial services and enhanced retail protections, such as the standardisation of margin close-out and negative balance protection, we and many other CFD issuers adopted these measures prior to the CFD Order, as a result of many years of self-regulation and industry competition. We do not believe these measures would be unwound if the CFD Order were to end.

D1Q2 - In your view, has the CFD Order been effective to date in reducing the risk of significant detriment to retail clients? Please provide evidence and data in support of your view where possible.

In our view, the CFD Order has not been effective in reducing the risk of significant detriment to retail clients. It has, however, deterred clients from continuing investing in CFD products, because the products themselves are no longer fit for investment purposes. The reduction in client losses and other key performance indicators are direct results of an abrupt reduction in trading activities.

Instead of investing in CFD products with Australian CFD providers, investors have moved to alternative high-return products, such as Cryptocurrencies, or moved to CFD providers located in other jurisdictions who are able to offer more flexible trading conditions.

We would also like to seek clarification on below aspects in CP348 which ASIC has relied on as evidence of a reduction in harm.

1. Reduction in Retail Client Losses

Paragraph 51 and 52 of CP348 states that:

> *"Retail clients made net losses of $22 million from CFD trading in the Effective Period—a 94% reduction compared with the quarterly average of $377 million net losses in the year prior to the Effective Date" and "Retail loss-making accounts incurred total losses of $756 million on average each quarter in the year prior to the CFD Order".*[1]

Our Comments

We do not believe it is accurate to associate the reduction in client losses as definitive evidence of a reduction in harm. We believe the reduction in client losses was more likely to have been caused by:

- The difference in the market conditions in 2020 and 2021. In 2020, the financial market experienced the most volatile period in history. Client losses recorded during this volatile

[1] CP348, para 51 and 52.

period significantly increased the quarterly average. Comparing these two time periods is not an accurate reflection of the effect of the CFD order without taking into consideration the market conditions relevant to each period of time into context.

- As a direct result of the CFD Order, there was a significant reduction in the number of retail clients trading CFDs with Australian CFD providers, and a significant reduction in trading activities.

2. Reduction in active Retail Client Accounts

Paragraph 62 of CP348 states that:

> *"The number of active retail client accounts decreased 29% to 357,841 in the Effective Period from 504,905 in the prior quarter, largely due to a declining number of foreign retail clients trading CFDs with AFS-licensed CFD issuers".*[2]

Our Comments

- Since the announcement of the CFD Order in October 2020, there has been a dramatic reduction in interest from foreign investors, as Australian CFD products were no longer competitive when compared to CFD products offered by some of the overseas CFD providers. In addition, we have ceased onboarding foreign clients due to ASIC's expressed view of Australian CFD providers dealing with foreign investors.

- Our average customer life expectancy is around 3 to 6 months. Without onboarding new foreign investors, our total foreign active client numbers have dropped significantly, which is reflected in ASIC's findings above.

- We note that not only have foreign investors stopped onboarding with us, but domestic investors have also lost interest in our products and opted for alternative investment products offering high-returns and flexible trading conditions, for example Cryptocurrencies. This is further outlined below in 'D1Q6' which outlines our customer survey results.

3. Reduction in Gross Notional Value and Client Money

Paragraph 14 and 63 of CP348 states that:

> *"With the introduction of leverage ratio limits, the size of retail clients' new CFD exposures reduced. The gross notional value of CFDs issued to retail clients in the Effective Period reduced 75% to $659 billion from $2.7 trillion in the prior quarter and was 86% lower than the $4.8 trillion in the quarter to 30 September 2020. We saw similar percentage reductions in the average gross notional value of CFDs issued per active retail client account."* [3]

[2] CP348, para 62.
[3] CP348, para 14.

"There was also a decline in retail client money holdings reported by CFD issuers. At 31 January 2021 retail client money held by CFD issuers owed to clients was $2.71 billion which decreased to $2.47 billion at 31 March 2021. Retail client money was $2.21 billion at 31 July 2021. Retail client money may be held for clients who are no longer active." [4]

Our Comments

- In our view, we do not believe it is accurate to associate the reduction in gross notional value and reduction in client money as evidence of a reduction in harm because of the CFD Order.

- As stated above, this data should be considered in connection with reduced trading activity as well as the reduced number of active retail clients over the period analysed by ASIC.

4. Parity between profit-making and loss-making retail client accounts

Paragraph 11 of CP348 states:

"The proportion of profit-making and loss-making retail client accounts was evenly split at 50% in the Effective Period, compared with a quarterly average of 36% profit-making accounts and 64% loss-making accounts in the four quarters prior to the Effective Date." [5]

Our Comments

- We note that ASIC has considered data from one quarter only, which in our view is an inappropriate time frame to make a significant decision on extending the CFD Order. In our view, this does not provide a true reflection over time, considering varying market conditions and the time customers and the markets needed to react to the new restrictions.

- According to our own data, the retail client loss-making rate was 61% in the two quarters following the CFD Order took effect. There has been a reduction to the loss-making rate but not to the extent stated in ASIC's findings. We request ASIC to review and disclose its calculation methodology in support of their findings.

- Research in the UK and Europe following leverage restrictions introduced in those regions in 2017 indicated that loss rates did not improve significantly. The loss-making percentage is more likely to be associated with market conditions and is typically over 65% for retail clients. These jurisdictions have had leverage restrictions in place for several years. Their data is a far better indicator of the impact of leverage on profit and loss percentages.[6] [7]

[4] CP348, para 63.

[5] CP348, para 11.

[6] FCA Policy Statement PS19/18 'Restricting contract for difference products sold to retail clients', https://www.fca.org.uk/publication/policy/ps19-18.pdf p 19

[7] EUROPEAN SECURITIES AND MARKETS AUTHORITY DECISION (EU) 2018/1636 of 23 October 2018 renewing and amending the temporary restriction in Decision (EU) 2018/796 on the marketing, distribution or sale of contracts for differences to retail clients, https://eur-lex.europa.eu/legal-content/EN/TXT/PDF/?uri=CELEX:32018X1031(01)&from=EN)

D1Q3 - For CFD issuers and distributors, if the CFD Order is not extended, would you change your business model and what costs would that incur?

In our view, if the CFD Order is **not** extended, we will continue with our existing business model and prioritise reversing the negative impact the CFD Order has had on our business. No additional cost is expected as many of the requirements in the CFD Order were already in place before the CFD Order was implemented. In addition, altering the leverage available to customers is no longer a challenge for us moving forward.

If the CFD Order is extended, we anticipate further reductions to our business in Australia. We may consider reducing our business scale and shifting our focus and efforts to other financial products.

D1Q4 - 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?

In our own analysis comparing data 6-months before and 6-months after the CFD Order was introduced, we saw a significant reduction in revenue, trading volume, client monies, and number of active traders. We found that the actual decrease we have experienced since the CFD Order was implemented has been significantly greater than the ASIC's findings disclosed in CP348.

In our view, if the CFD Order were to be extended, we project further reduction of our business which will lead to further downsizing of the business operations in Australia.

Paragraph 120(b)(ii) of CP348 states:

> *"(b) will strike an appropriate balance between:*
> > *(i) reducing the risk of the significant detriment to retail clients resulting from CFDs;*
> > *(ii) the financial and other impact of the proposed orders on issuers and consumers of CFDs;*
> > *(iii) and any effects on competition in the Australian financial system."* [8]

We disagree that an appropriate balance has been struck as the CFD Order has had a significant financial impact on our business, the industry in general and the competitiveness in the Australian financial system.

D1Q5 - 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 have already disclosed our ongoing implementation costs of the CFD Order in our quarterly data submission to ASIC. While we acknowledge the ongoing implementation cost is small, it is the further loss of revenue and business opportunity that predict a bleak future for our business and our industry.

[8] CP348, para 120 (b)(ii).

<u>D1Q6 - For retail clients of CFD issuers, has the CFD Order changed your trading? If so, please explain how. For example:</u>

- ***<u>(a) has the frequency of your CFD trading changed?</u>***
- ***<u>(b) have you committed more-or-less margin to CFD trading?</u>***
- ***<u>(c) have you substituted other investment products for CFDs?</u>***
- ***<u>(d) do you use CFDs for hedging other investment risks? If so, what proportion of your CFD trades?</u>***
- ***<u>(e) what impact have financial losses or profits from CFD trading had on you?</u>***
- ***<u>(f) do you consider you would have made higher profits or higher losses if the CFD Order had not been in effect?</u>***

We have conducted a survey to collect feedback from our clients who actively traded before and after the CFD Order was implemented. Please note, the survey findings do not reflect the opinions from the clients who have left us due to the CFD Order.

From the survey, for clients who continued to trade with us after the CFD Order, they trade less frequently than before, committed more margin in order to maintain the same position size, and a lot of them have substituted CFD trading with other investment types. Hedging is an important reason for CFD trading. And our current clients are informed, experienced, and aware of the risk of trading CFDs. The survey participants have expressed a view that the leverage restrictions have changed the risk/reward balance of the product.

(a) has the frequency of your CFD trading changed?

- 39% stated that the CFD order has affected their trading frequency.
- After the CFD Order was implemented, there was an increase of clients who started to trade less frequently.

(b) have you committed mor-or-less margin to CFD trading?

- 43% committed more margin.

(c) have you substituted other investment products for CFDs?

- Cryptocurrency - 53%
- International Shares - 42%
- Domestic Shares - 33%
- ETFs and Other investment products - 30%

(d) do you use CFDs for hedging other investment risks? If so, what proportion of your CFD trades?

- 22% had at least 5% or more of their CFD trades placed for the purpose of hedging other investment risks.

(e) ***what impact have financial losses or profits from CFD trading had on you?***

- Majority of respondents stated that financial profit or losses from CFD trading had little to no impact on them as they recognised that financial profits or losses were a part of trading and investing; and CFD trading is not different from other investment products.
- Respondents shared the view that it was important to be aware of the risks involved when trading.

(f) ***do you consider you would have made higher profits or higher losses if the CFD Order had not been in effect?***

- Approximately 33% stated they would have made higher profits.
- The rest of the respondents felt that they would have had higher losses, but believed that the restriction to leverage meant that they have lost the flexibility when trading and meeting margin requirements.

D1Q7 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?

For CFD investors - CFD products are designed for investors seeking a high-risk, high return investment. CFD products provide an efficient means of accessing global financial markets with lower capital requirements when compared to buying the asset itself. There is now no similar product available to retail investors wishing to trade high volumes in a cost-effective way.

For CFD issuers – we have been significantly impacted by the CFD Order. If it is extended, our industry will be further disadvantaged as the products we could offer do not appear to be suitable for one of our primary target markets, being, experienced traders seeking a high-risk and high return investment.

Recommendations

In accordance with our reasoning provided above, we put forward the following recommendations:

1. That the CFD Order is not extended, allowing other regulatory obligations to protect vulnerable and unsuitable investors from utilising the products.

2. Should the CFD Order be extended:
   (1) New Classification of Client
   We recommend introducing a new classification type of client between retail and wholesale to cater for clients who do not meet the criteria of income or assets tests.

   (2) Re-introduce Higher Leverage Levels

Alternatively, we recommend keeping existing lower leverage levels set out in the CFD Order as the default setting. However, clients who formally certify that they have the relevant experience and knowledge of CFD products, should be allowed to seek and trade at higher leverage levels, whilst still benefiting from retail protections.

Conclusion

We acknowledge that the CFD Order has achieved some positive outcome in protecting retail investors. However, we believe there is no requirement to extend the CFD Order because some of the changes set out in the CFD Order were put into effect before the intervention order commenced and that additional financial services laws have subsequently been implemented to enhance the protection for retail clients.

Furthermore, we do not believe the CFD Order is effective in reducing significant risk of detriment to retail clients. Should it continue, we believe necessary change should be made, namely investors should be reasonably given more flexible leverage options in order to meet their trading needs.

Yours Sincerely

[redacted]

Xu Lu
Director
International Capital Markets Pty Ltd