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29 November 2021

Retail Complex Products and Investor Protection
Market Supervision
Australian Securities and Investments Commission
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 ("CP 348")

The Australian CFD and FX Association ("**Association**" **"we" "us" "our"**) is an alliance of domestic retail over-the-counter ("**OTC**") derivative providers, established to promote consumer protection and healthy industry competition and standards. Our members are margin foreign exchange ("**FX**") and contracts for difference ("**CFDs**") (together, "**CFD Products**") issuers who offer their products to retail and wholesale clients in Australia. We would like to thank ASIC for providing us with the opportunity to comment on whether the ASIC Corporations (Product Intervention Order—Contracts for Difference) Instrument 2020/986 ("**CFD Order**") should be extended.

The CFD and FX Industry (the **"Industry**") provides Australian investors with access to speculative trading products. In the case of many of the products we offer, there are no cost-effective alternatives available for retail investors to gain short-term exposure to the underlying assets.

The Association remains in support of improved standards in Australia where these even the playing field and ensure that investors, particularly vulnerable investors, are protected. We have no issue with many aspects of the CFD Order and note that several Industry participants had already effectively implemented many of the protections, such as, negative balance protection, the restriction of egregious inducements and requiring standard close-out terms, prior to the CFD Order being in place but believe there are serious issues with the CFD Order that need to be considered.

We have summarised our concerns with the CFD Order as it is currently drafted as follows:

(1) **The leverage restrictions imposed by the CFD Order have fundamentally changed what CFD Products are –** We believe this is the principal issue with the CFD Order. The restrictions have increased the cost of trading and changed the risk/reward balance of CFDs so fundamentally that the products are no longer fit for purpose for the experienced retail investors, particularly the high-volume, speculative day traders that they are most suitable for.

(2) **The leverage restrictions imposed by the CFD Order have not been materially effective in reducing investor harm –** it is clear that restricting leverage has not materially reduced harm to clients, as evidenced by:

   a. comparing the percentage of loss-making accounts between asset classes with different leverage; and
   b. the percentage of loss-making accounts by comparing retail to wholesale accounts and in particular, the experience in UK and Europe after those jurisdictions introduced leverage restrictions.

   This data is detailed below at our response to **question D1Q2**.

(3) **The CFD Order no longer appears necessary –** Recent changes to financial services regulations mean that the CFD Order now plays a far less significant role in protecting vulnerable retail clients. The recently enhanced protections for retail clients include:

   a. the design and distribution obligations,[1] which mandate product issuers to distribute their products only to those investors that are likely to be suitable for the product; and
   b. stronger anti-hawking restrictions,[2] which helps prohibit unsolicited sales and in turn helps prevent vulnerable or inappropriate investors from engaging with products that are not suitable for them.

(4) **Investors are willing to give up protections for broader trading options –** Following the CFD Order, there has been a dramatic increase in investors willing to nominate for wholesale status or trade offshore just to continue to trade CFD Products *in the way that they want to*. This will be even more of an issue if the sophisticated investor definition[3] (allowing retail clients to nominate to become wholesale based on their knowledge or experience) is limited or removed.

(5) **The cost to industry, other financial service providers, and to the Australian economy is material** - On average less than 5% of revenue in our industry is directly related to client loss. Our revenue primarily comes from commissions and the mark-up to the institutional wholesale spreads we source. The reduction in trades and clients has already had a significant impact on our industry and other third-parties (such as our payment providers and the broader economy) which is likely going to get worse if the CFD Order is extended.

(6) **The impact of the CFD Order appears to be inconsistent with current Government statements regarding investor autonomy** - Senator Hume recently made the following statement about cryptocurrency trading:[4]

   > *"If you want to punt a portion of your savings on something speculative – knock yourself out. No government should stand in your way. But you should be prepared to wear it when it goes wrong."*

   Unlike cryptocurrencies, CFD Products are heavily regulated and arguably provide far more protection to investors that want to trade them. It is not clear why CFD Products should be seen differently.

[1] *Treasury Laws Amendment (Design and Distribution Obligations and Product Intervention Powers) Act 2019.*
[2] *Financial Sector Reform (Hayne Royal Commission Response) Act 2020.*
[3] s761GA, *Corporations Act 2001.*
[4] 'Crypto no fad, Hume tells RBA', Financial Review, 22 November 2021, https://www.afr.com/politics/federal/crypto-no-fad-hume-tells-rba-20211121-p59aof

Recommendation

Given that the benefit of the CFD Order appears negligible (with many clients in fact being adversely impacted) and the cost to Industry is so great, we make the following recommendation:

- That the CFD Order is not extended, allowing other regulatory obligations to protect vulnerable and unsuitable investors from utilising the products.
- Alternatively, should the CFD Order be extended:
    - It is critical that there is a carveout allowing experienced investors to trade at higher leverage levels, without it this would be terminal to the CFD industry in Australia. We recommend keeping existing lower leverage levels as a default setting, but allowing investors an option to trade at a higher leverage if they choose by formally certifying that they are experienced and knowledgeable about CFD Products, and that they understand and accept the risks of trading them.
    - This means investors regain their trading choices while still maintaining retail protections and continuing to trade in Australia under Australian regulatory oversight.

Response to CP 348 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)?

The Association does not agree with extending the CFD Order for any period of time as we believe no additional time is needed to assess the effectiveness or impact of the CFD Order.

The leverage restrictions imposed by the CFD Order have morphed CFD Products into different products, severely impacted their value and making them no longer of use to experienced high volume speculative traders that have utilised them in the past. Our view is based on the following factors:

- Traditionally, CFD investors trade frequently and hold their positions open for only a short time (on average >90% close their positions in less than 1 day). The cost of trading for these investors to facilitate multiple trades, versus the new leverage restrictions and the amount of return they will get on those trades, means retail CFD Products are no longer economically viable for them as ASIC retail investors.

- Informing our view that high-volume traders are no longer trading CFD Products as retail investors, some of our members have reported:
    - between nearly **50% and up to 90% reduction** in the average number of trades on a retail trading account;
    - a **75%+ reduction** in accounts undertaking over 10 trades a week; and
    - an **83%+ reduction** in accounts undertaking over 50 trades a week.

- CP 348 states that the average profit per retail profit-making account fell 62%.[5] This alone indicates the risk/reward aspect of CFD Products has changed.

[5] CP 348, para 55.

These statistics suggest that that the CFD Order has inherently changed the product for retail investors. Without a suitable product to trade, the CFD Order has forced traditional experienced and knowledgeable investors to seek wholesale classification or move off-shore to be able to continue to trade the way they want to.

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.

The Association does not believe the CFD Order has been effective, in fact we believe it has caused more harm to experienced investors, many of whom have chosen to give up their retail protections or trade offshore to facilitate the type of trading they want.

We would also like to highlight the following issues, including aspects in CP 348 that ASIC has relied on as evidence of a reduction in harm, which we believe require additional clarification:

1. **Restricting leverage is not an avenue to reduce harm**

ASIC has stated:[6]

> "*In the Public Notice, we explained that the leverage ratio limits in the CFD Order would reduce CFD exposure and the sensitivity of CFDs to market volatility, which we expected to reduce the size and speed of retail clients' CFD losses."*

If leverage was a principal factor in investor loss, it would follow that restricting leverage would have a material impact on loss ratios. However, in comparing loss ratios between (i) wholesale and retail investors; and (ii) between asset classes with different leverage restrictions, we see that restricting leverage does not reduce investor harm.

We note that ASIC has drawn its conclusions based on data from only one quarter, which in our view is a less than ideal timeframe. The trends that we see in the UK and Europe following leverage being restricted in those regions in 2017 is a far better indicator of the impact of leverage on profit and loss percentages. Those restrictions have now been in place for a number of years, and loss rates for retail investors continue to **typically be over 65%**.

International regulatory experiences have shown that the loss rates were more likely to be associated with market conditions than other factors, and not restricted leverage:

- **The loss rates in the UK have not significantly changed since the leverage restrictions were implemented and the FCA has stated:**

  "We recognise that the percentage of loss-making retail client accounts may not improve and that profitable trades may be less profitable when trading at lower leverage."[7]

- **ESMA found profitability of retail accounts actually went down after they implemented product restrictions, noting it was likely more about market conditions:**

[6] CP 348, para 67.
[7] 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.

> *"The share of profitable retail client accounts decreased slightly, but this appears to be mainly arising from the soaring prices of cryptocurrencies in August 2017. Comparing client outcomes over time is not only impacted by the product intervention measures, but also for example by market conditions. Market conditions in August 2017 were bullish in comparison to August 2018.*"[8]

Regarding asset classes, in 2017, 63% of investors trading Margin FX products (the asset class with the highest leverage) lost money, while the loss rate for other CFD products (with lower leverage) was 9% higher, at 72%.[9] This already demonstrates a material difference between asset classes that could impact loss figures if all asset classes are combined.

2. Reduction in gross notional value of CFDs issued and client money held

ASIC has stated:[10]

> "*We have observed significant improvements in a number of key metrics and indicators of retail client detriment from CFD trading in the three months following the implementation of the CFD Order (Effective Period)...*
>
> *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."*

And in relation to client money:[11]

> *"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."*

It is important to note that there was a **29% reduction of retail investors in CFD Products** who were the higher value traders that disproportionally represent a very large segment of client money and volumes during the periods examined.[12] It therefore stands to reason that client money and gross notional value will be materially reduced, as less investors are trading our products and less trades are being made.

It is also not accurate to automatically associate the reduction in gross notional value of CFD Products issued and client money as definitive evidence of a reduction in harm. CFD Products are called "contracts for difference" because investors are only liable to pay the difference in price between when they purchase the product and when they sell it, they are never required to pay

[8] 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, distr bution 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

[9] CP 348, para 40(a)(i).

[10] CP 348, paras 9 and 14.

[11] CP 348, paras 63.

[12] CP 348, para 62.

the entire exposure amount and therefore only invest the proportion of money they are willing to lose, as opposed to investing in unleveraged products such as physical shares.

All these statistics conclusively show is that less retail investors are trading CFD Products.

3. Relying on a volatile 5-week period as an indication of clear loss and harm

ASIC has reviewed and relied on data from during "*a volatile five-week period in March and April 2020*" when looking at:

- a comparison of retail positions terminated by margin close-out.[13]
- a comparison of retail trading accounts that fell into negative balance.[14]

The market conditions at the time the data was collected are relevant when assessing that data and drawing conclusions regarding the impact on clients. We note during this 5-week period:

- in one week during that same time period the Dow futures fell more than 1,000 points and Standard & Poor's 500 futures dropped 5%, triggering a circuit breaker; and
- on Monday 16 March 2020, Asia-Pacific and European stock markets also significantly fell, with the S&P/ASX 200 setting a one-day record fall of 9.7%, collapsing 30% from the peak that was reached on 20 February.

Examining impact in extreme market conditions does not appear to be an objective standard that should be used as an indicator of harm to justify a permanent limitation on a product.

4. The calculation of loss rate percentages are not consistent with industry standards

The loss rate percentages provided by ASIC include costs and fees.[15] This seems inconsistent with how other products are treated when assessing the profitability of an investment.

By way of example, a typical stockbroker may charge a minimum $10 brokerage on lower value trades.[16] If an investor were to invest just $1,000 on a share purchase, the minimum cost of placing and closing out the trade would be $20. A purchased share would therefore have to increase by $20 for the investor to not make a loss when selling it. These fees would not typically be considered when looking at the loss in a share investment portfolio.

ASIC has also calculated the loss rate using a method that does not account for the quantum of loss. By way of example, one client could lose $1 and another could make a profit of $1,000 but that has been counted as a one losing trading account and one winning trading account. This may skew the percentages and make CFD Products look more harmful than they are in reality.

5. Claims about the reduction in harm from negative balance protection

ASIC has said: [17]

[13] CP 348 para 3(b)(i) and 40(b)(i).
[14] CP 348 para 3(b)(ii) and 40(b)(ii).
[15] CP 348 para 28.
[16] See, for example, https://www.commsec.com.au/support/rates-and-fees.html (as at 25 November 2021)
[17] CP 348 para 86.

"The negative balance protection in the CFD Order has prevented at least 1,311 retail client accounts from incurring a liability greater than the funds in their CFD trading account."

However, as ASIC acknowledges many CFD issuers had already adopted the practice of forgiving negative balances prior to the CFD Order being implemented. As we and ASIC understand, prior to the CFD Order this was often informal policies and practices.[18]

As a consequence of the CFD Order, many issuers dedicated time and resources to automate or more formally implement procedures dealing with negative balance protection. We have no reason to believe this would be unwound if the CFD Order were to end.

In addition to the rationale listed by ASIC in CP 348[19], we would add that industry competition is a compelling motivating factor for other CFD Issuers to continue to offer negative balance protection to retail clients.

6. Claims about the reduction in harm from the margin close-out requirement

ASIC has said: [20]

"Where a margin close-out occurs, it can be inferred from the liquidation level having been reached that the retail client holding the positions lost a significant proportion of their investment"

In our view, margin close-out occurrences themselves are not a convincing indication of actual harm to retail investors as:

- a margin close-out occurs across a single trading account, not across an entire client account. It may be that an investor has multiple accounts dealing with a number of trading strategies. A margin close-out may occur on one trading account even when an investor has significant funds elsewhere;
- the above statement from ASIC gives the impression that retail investors commit significant funds to their trading accounts, however, CFD Issuers are very clear with their education, marketing and disclosure that investors should not invest more funds than they can afford to lose. The funding of CFD trading accounts therefore tends to be very different when compared to other more traditional long term investment products. Investors are not investing with a view to guaranteed capital growth and will not be risking a large percentage of their overall savings or money they are reliant on; and
- finally, the principal purpose of CFD Products is to allow investors to be able to open a position with a fraction of the funds required to gain exposure to the actual asset. There is no obligation for them to have any more funds in their trading account than is required to open and maintain that position.

Having raised these points of clarification, we note that this element of the CFD Order is not considered to be a material issue to our Association.

[18] CP 348 para 89.
[19] CP 348 para 89.
[20] CP 348 para 77.

7. Inappropriate inducement practices

We agree that unreasonable pressure or inappropriate inducements, particularly those targeted at inexperienced or vulnerable investors, to trade products such as CFDs and FX is inappropriate.

It is the Association's view that the majority of Australian CFD Issuers were not offering inducements that were inappropriate prior to the CFD Order. Our understanding is that these inappropriate practices are primarily engaged in by the smaller or unregulated Issuers.

That said, Australian regulation already has several provisions that protect against this type of inappropriate behaviour, some of which have been recently reformed since the CFD Order was implemented:

- the strengthened anti-hawking requirements,[21] which help prohibit unsolicited sales;
- the design and distribution obligations,[22] which works to ensure products are not distributed to inappropriate investors;
- the conflicted remuneration provisions;
- the broad conflict of interest management obligation; and
- the various misleading and deceptive provisions provided by Australian Consumer Law.

We are strongly of the view that the standards imposed on the financial services industry as a whole are adequate to protect investors in CFD Products against inappropriate inducement practices and there is no basis to single out the CFD Industry versus any other financial services industries. In our view it is more appropriate to consider broader financial services reforms should ASIC continue to be concerned about inducement practices.

8. Australian regulation now has suitable alternatives protecting vulnerable investors

Since the CFD Order was enacted, new financial service regulations have become a part of Australian requirements for the broader financial services industry, namely:

a. design and distribution obligations (*Treasury Laws Amendment (Design and Distribution Obligations and Product Intervention Powers) Act 2019*); and
b. stronger anti-hawking restrictions (*Financial Sector Reform (Hayne Royal Commission Response) Act 2020*)

These obligations, along with many other aspects of the Australian financial services regime, are designed to help prevent the distribution of products to consumers that are unsuitable or prohibit unsolicited sales, which will now assist in the prevention of vulnerable investors accessing the products we offer.

The role that the CFD Order plays in protecting vulnerable retail clients is now far less significant. These other regulations are sufficient alone in protecting vulnerable retail clients and do so in a way that does not fundamentally change CFD Products so that they are no longer suitable for the traditional CFD investor.

[21] *Financial Sector Reform (Hayne Royal Commission Response) Act 2020.*
[22] *Treasury Laws Amendment (Design and Distribution Obligations and Product Intervention Powers) Act 2019.*

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?

Many of the requirements in the CFD Order were already being undertaken by the Association members prior to the Order being introduced. In addition, retail investors have always had the option to reduce their leverage to the levels stated in the CFD Order and could continue to set them to those levels if the CFD Order was not extended.

It is not clear what "change your business model" means. However, if the CFD Order is extended we anticipate that the reduction of Australian business will force CFD Issuers to focus their efforts on other jurisdictions. This may lead to the closing of the Australian operations entirely. This would be particularly relevant if ASIC or Government decides to change the options for experienced and knowledgeable investors to nominate to be wholesale investors under the Sophisticated Investor decision.

On this point, we note that the previous change to the Australian wholesale definition in Australia, which specifically targeted our Industry, was part of seemingly unrelated reforms and was not subject to clear public consultation with us as impacted parties.[23] We believe this is an unfair treatment of our Industry and ask that this type of experience not reoccur.

In terms of cost of unwinding the CFD Order impact; many of the costs incurred by Industry in implementing the CFD Order were associated with automating and formalising policies that were already in place. These measures will likely stay in place and not require any additional cost. There may be minor administrative costs in removing the mandatory nature of aspects such as the leverage caps, but this would easily be recouped in the savings from other avenues (such as not requiring as many dedicated retail trading servers etc.)

As stated above, investors have always had (and will continue to have) the ability to adjust their leverage to the levels they want. Even if the CFD Order was not extended, investors would have the option to continue with the restricted leverage levels on their trading accounts if they wanted to.

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?

The CFD Order has had a significant financial impact on CFD Issuers. We have grouped the costs into the following categories:

1. **Reduction in revenue**

   The CFD Order has led to a significant reduction in clients and an even more significant reduction in revenue, particularly as a result of the material reduction in trades due to the decrease of high volume CFD traders.

   It has fundamentally changed the products we offer and, as a result, most of our primary clients are looking for alternatives to trade.

   ASIC has noted a 29% reduction in retail investors but the actual business impact is even greater than the 29% would suggest.

[23] This point relates to the carve out included in Corporations Regulation 7.1.22AA which only applies to CFDs, inserted by *Treasury Laws Amendment (Miscellaneous Amendments) Regulations 2019*. This carve-out was not included in the initial draft amendment released for consultation, consequently, our Industry was not afforded the opportunity to comment on this law that only impacts its investors.

There appears to be a misunderstanding as to how our member generate revenue. ASIC has previously stated:

> *"As explained in Consultation Paper 322 Product intervention: OTC binary options and CFDs (CP 322), retail clients' net financial losses in 2018 from trading CFDs with 60 licensed CFD issuers in Australia were a component of the $1.5 billion gross trading revenue that the CFD issuers received in 2018. CFD issuers' gross trading revenue* ***largely can be attributed to a combination of net client trading losses and spreads, fees and commissions charged to clients****"*[24] (emphasis added)

We strongly object to ASIC combining these revenue streams without further explanation, principally, for the largest providers of CFD Products client trading losses contribute on average **less than 5% of annual trading revenue**.

Our primary source of revenue is earned from spreads (the difference between the buy and sell price for a product), fees and commissions, but that is the same for many businesses. CFD Issuers take various wholesale pricing from liquidity partners, such as investment banks, slightly mark-up the wholesale price at a fixed rate, and allow retail investors to trade the products. This is no different to any other retail business in Australia. By way of illustration, a bank will offer a retail investor a broader spread when exchanging currency while also charging a commission for the service and this is common, accepted practice.

In the context of the CFD Order we do not believe spreads and commissions should be classified as client loss and considered as evidence of harm, rather they should be seen as part of the cost to CFD Issuers. The reduction in trades has directly impacted the primary source of revenue for the Industry and it should be considered in light of that.

We anticipate the ongoing impact to be a steady decline in our business until either:

- there is no economically viable reason to remain based in Australia; or
- the number of new types of investors is enough to support continued operations, although likely in a far more streamlined and cut-down way. Current businesses that are operating here could not sustain their full operations based on CFD products as they now are under the CFD Order.

This would especially be the case should ASIC or the Government impact the ability for experienced investors to nominate to be classified as wholesale.

2. Internal resources dedicated to implementing the CFD Order or related dealings with ASIC

We believe Association members have already provided ASIC with detailed information about the internal resources dedicated to implementing the CFD Order.

We would also like to highlight the concerns raised by our members about the significant time and resources spent responding to ASIC's multiple requests for information under its compulsory notice powers. While we appreciate that ASIC needs to review the impact of the

[24] *ASIC Public notice—Product intervention order in relation to contracts for difference,* October 2020, paragraph 16.

CFD Order, these notices are often detailed and required diverting significant internal resources away from our members' usual business to investigate and respond.

3. **Cost impact on other financial services licensees and the broader Australian economy**

We would like to briefly acknowledge the wider impact on other financial services businesses in Australia who provide related services to CFD issuers, such as payment service providers, Australian ADIs and the broader economy. These, largely unseen, parties benefit greatly from CFD Issuers being a strong industry in Australia.

An Association member estimates that in the six months since the CFD Order was in place there has been an approximate 77% reduction in payments and transaction fees paid to Australian ADIs, which we anticipate is equivalent to several million dollars in lost earnings for them across our industry. Another Association member estimates a 67% drop in the client funds held in Australian ADIs.

Australian businesses are also downsizing their staff and there is a material reduction in the amount of taxation paid to support the Australian economy, based on the current trajectory, estimated reductions in tax paid in Australia by some of our members of over 85%.[25] Anecdotally we have also heard of some businesses considering shutting down their Australian operations all together.

Finally, the CFD Order has and will continue to lead to a reduction in speculators. Speculators play an important role in markets, as evidenced in multiple academic studies,[26] they create liquidity reducing the costs of trading for all, including superannuation funds and mum and dad retail investors with longer term investment horizons.

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 asked our Association members to provide individual submissions on this particular aspect.

D1Q6 For retail clients of CFD issuers, has the CFD Order changed your trading? If so, please explain how. For example:
(a) has the frequency of your CFD trading changed?
(b) have you committed more or less margin to CFD trading?
(c) have you substituted other investment products for CFDs?
(d) do you use CFDs for hedging other investment risks? If so, what proportion of your CFD trades?
(e) what impact have financial losses or profits from CFD trading had on you?
(f) do you consider you would have made higher profits or higher losses if the CFD Order had not been in effect?

We have asked our Association members to forward the consultation on to interested clients but note that some of the information in our commentary above would be relevant to this question.

[25] Based on tax paid in FY20 and estimates for FY22.
[26] '*Understanding the Role of Speculators*', CME Group, accessed 25 November 2021
https://www.cmegroup.com/education/courses/introduction-to-futures/understanding-the-role-of-speculators.html#

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?

We are concerned that our industry is being viewed and treated differently from other financial services industries operating in Australia, noting that we are already subject to many regulatory requirements that other industries do not have to contend with (such as the CFD specific Net Tangible Assets requirements,[27] the enhanced disclosure required by RG 227, the Client Money reforms and the restrictions on being able to use 'price and value test' when classifying customers as wholesale clients).

For investors: CFD Products are designed for investors seeking a high risk, high reward product. The CFD Order has so fundamentally changed the product for retail investors that, in the case of many of the products we offer, there is now no similar speculative product available to retail investors looking to cost-effectively trade in high volume in Australia.

For CFD Issuers: Should the CFD Order be extended and any additional financial services reforms take place (such as any additional changes to the wholesale investor definitions) we would be significantly disadvantaged, as the retail products we could offer do not appear to be suitable for our primary target market which are high volume traders.

Conclusion

The policy discussions around the use of the Product Intervention power have been very consistent in that the power is only to be used in the most extreme cases and is not intended to prevent monetary losses or eliminate all risk [28]

Many of the changes required by the CFD Order were practices already being undertaken by those CFD Issuers with the largest market share prior to its implementation. In addition, there have been multiple subsequent financial services reforms (such as the design and distribution obligations and the reformed anti-hawking requirements) which will likely address many of the concerns ASIC has previously raised.

We are of the view that ASIC is unable to demonstrate any clear evidence that the leverage restrictions in the CFD Order has changed its primary source of investor harm - being the losses clients experience in trading CFD Products. All it has done is fundamentally change the product into one that traditional CFD traders are unable to use for their high-volume speculative trading. This has left those clients with only two options to continue to trade the way they want – nominate to become wholesale investors or trade with offshore entities. It has also left the industry in a dire position as the traditional trader, the type that has been around for the 20+ year history of the industry and who contributes the most to their businesses, is no longer interested in trading retail CFD Products in Australia.

It is worth noting that the ASX attempted to offer a similar limited leverage ASX listed CFD product to retail investors in Australia in 2013,[29] but the product was short lived as there was little interest and it could not compete with the products, conditions and pricing offered by Australian over-the-counter CFD Issuers. The ASIC CFD Order is forcing this once successful industry in the same direction.

The Association acknowledges that there are bad actors in our industry, but again stresses that most of these are unregulated. While there may be a small number of licensed entities not doing the right thing, we believe it is a mistake to use a 'blanket ban' approach against all of Industry when the majority of

[27] Under ASIC Class Order 12/752.
[28] ASIC Regulatory Guide 272 Product intervention power, RG 272.6.
[29] ASX 'Module 2: How do ASX Listed CFDs work?', Version 1 August 2013
https://www.asx.com.au/documents/resources/module_2_How_do_ASX_Listed_CFDs_work.pdf?cfd_course_02_text

licensees do have appropriate systems, policies and processes in place to ensure investors are not harmed. We note that AUSTRAC has recently warned banks against using a similar industry wide ban to de-risk: "*de-banking legitimate financial services businesses can increase the risks of money laundering and terrorism financing and negatively [impact] Australia's economy*", [30] stating that they should adopt more of a case-by-case approach when assessing the risk of a business instead. We are concerned about the same thing in our Industry, and that continued over-regulation will just encourage investors to move their business offshore.

To lose this Industry would be a devastating outcome, not just to CFD and FX businesses but to Australian investors. Even with some of the equity and index CFD Products that are offered, the cost of investing in the underlying asset (and the brokerage charges associated with short term investing) would mean those types of speculative activities would be out of reach for many Australian retail clients. It would force those clients to move offshore and we are of the view that is far more of a significant harm to Australian retail investors.

We do not believe the CFD Order is necessary or effective. Should it continue, we believe that the alternate option we have presented, namely investors being allowed to formally certify and request higher leverage in order to meet their trading needs, would satisfy ASIC's concerns regarding inappropriate investors accessing the product while maintaining investor choice.

Please let us know if we can provide any additional information on the matters we have raised in this submission.

Yours respectfully,

[redacted]

Peta Stead
Director
Australian CFD and FX Association

[30] *AUSTRAC statement 2021: de-banking*, 29 October 2021, accessed 25 November 2021, https://www.austrac.gov.au/news-and-media/media-release/austrac-statement-2021-de-banking