Plus500AU

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RESPONSE TO ASIC CONSULTATION PAPER

CP 348 Extension of the CFD product intervention order

INTRODUCTION

Plus500AU Pty Ltd (**us**, **we** or **Plus500AU**) welcomes the opportunity to comment on ASIC's Consultation paper 348 (**CP 348**), which proposes to extend the Product Intervention Measures **(PIO)** on contracts for difference (**CFDs**) until it is revoked.

WHO WE ARE

Plus500AU has held an Australian Financial Services Licence (Number 417727) since 2012, authorising it to provide financial services in relation to **CFDs**. Plus500AU has also been granted a New Zealand Derivatives Issuer Licence FSP #486026 and is authorised as a Financial Services Provider in South Africa, FSP #47546.

The Trading Platform is accessible from multiple operating systems (Windows, smartphones (iOS, Android and Windows Phone), tablets (iOS, Android and Surface), and web browsers).

Plus500AU has implemented all Product Intervention Order requirements as of March 28, 2021.

EXECUTIVE SUMMARY

Plus500AU supports ASIC's work on protecting Australian retail clients from predatory practices within the financial services industry, which result or are likely to result in consumer detriment. We fully support initiatives that are designed to strengthen consumer protection and believe that **proportionate measures** can be taken to ensure this.

In summary, our feedback is as follows:

1. The data relied on by ASIC was collected over a very short period after the introduction of the Product Intervention Order and it is not sufficiently representative to support the extension of the order for a 10 year period. A temporary extension of the PIO is better, to allow more time to collect data and be in a position to make objective, representative comparisons and understand long term consequences.

2. The commencement of the Design and Distribution Obligations in October 2021 effectively addresses the question of the suitability of CFDs for retail traders more adequately, on a case-by-case basis, rather than by making a blanket order which applies to all retail traders.

3. Retail CFD traders' interests have not been taken into account.

Relevance of data relied on to justify extension of the PIO

A key basis on which ASIC proposes to rely on to extend the PIO is information it has collected during previous market surveillance activity. This data was collected over a very short period of time and compared results obtained during completely different market conditions.

The data ASIC relied on when proposing to extend the PIO for a period of 10 years is insufficient to provide a clear and accurate picture of the effects these measures had on CFD providers and CFD traders.

Further, ASIC has not released the regression modelling, data it used or the assumptions it relied on in reaching its conclusion about "statistically significant, negative correlations" between the PIO and margin close-out experience and loss-making accounts. In our view, any proposal to extend the temporary PIO should not occur until ASIC has released the full modelling it relies on and given the CFDs industry an opportunity to consider the modelling.

Comparisons

ASIC's data suggests a reduction in client detriment, but does not take into account the fact that the leverage limitations introduced by the PIO have effectively created a new product and any comparison would need to be made keeping in mind all the features of the product.

Similar to the provisions of RG 234 *Advertising financial products and services*, products with sufficiently similar features may be compared, but highlighting one feature while ignoring another feature may be misleading (for instance, mentioning a percentage return for one product while omitting the percentage return on another or

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comparing results obtained by effectively trading 2 different types of products traded under different market conditions).

According to CP 348.10 retail client losses reduced from a quarterly average of $372 million in the year prior to the PIO to $22 million in the 3 months after the introduction of the PIO. This decrease needs to be considered in light of the different market conditions for the relevant period and the 29% decline in the number of retail clients (largely due to a declining number of foreign retail clients trading CFDs with AFS licensed issuers).

Low leverage limits drove clients to unregulated CFD providers

The introduction of ASIC's proposed leverage limits resulted in a number of CFD providers obtaining licences offshore and transferring Australian clients to jurisdictions which allowed higher leverage. Plus500AU did not take this approach.

Anecdotally, Australian clients who wanted to trade with higher leverage limits as part of their trading strategy have also been driven to entities operating outside of the Australian regulatory environment. This exposes Australians to entities which are often not subject to comparable regulatory oversight and, thus, may not have sufficiently robust compliance procedures in place to ensure compliance with strict licensing, conduct and disclosure obligations, which includes the obligation to do all things necessary to ensure that financial services are provided to clients efficiently, honestly and fairly.

Volatility -*The periods compared*

ASIC attempts to demonstrate that the PIO strengthened protections for retail clients trading CFDs by referring to data collected in 2017 and 2020 (prior to these orders) with data collected over a brief 3 months period, immediately after the introduction of the restrictions. ASIC found that CFDs have resulted in significant detriment to retail clients of 13 CFD issuers, who made a net loss of more than $774 million during a highly volatile five-week period in March and April 2020.

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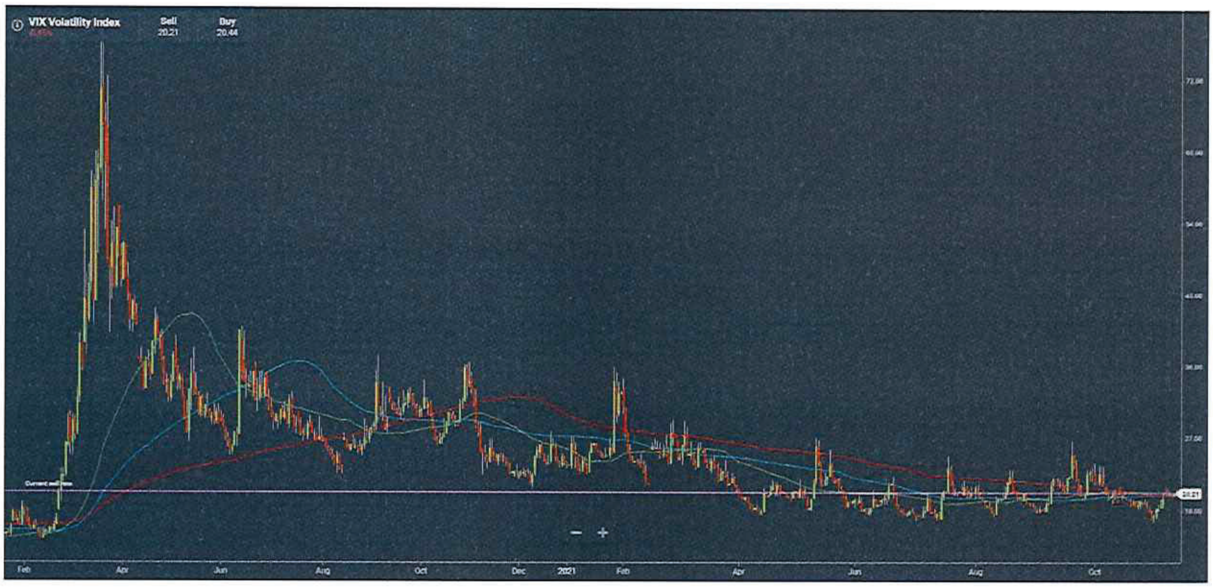
Below is a screenshot of the chart of the Volatility Index[1] since the beginning of 2020. It traded as high as 80.00 on 18 March, 2020. The last time it traded above 40.00 was 11 June, 2020 and has not been above 30.00 since 1 February, 2021.



March 2020 saw one of the most dramatic stock market crashes in history. In barely four trading days, Dow Jones Industrial Average (DJIA) plunged 6,400 points, an equivalent of roughly 26%. Between 20 February, 2020 and 23 March, 2020, the ASX200 fell 2,616 points from 7,162.50 to 4,546.00 (a loss of 36%).

Other Market Events which resulted in investor losses, such as the unexpected market gapping event as a consequence of the Japanese Yen flash crash and the Oil prices crash on April 20, 2020, were completely independent of OTC derivatives trading.

In fact, on that day, WTI traded at a negative price on the NYMEX for the first time in history. This was an unprecedented event and trading results during this period should not be included in current market comparisons.

The one-day plunge in WTI Oil was the largest based on records going back to 1983, and the settlement was the lowest on record, according to Dow Jones Market Data, marking the first and only time a contract closed with a negative value.

[1] Plus500 platform

Plus500AU

These unusual events are statistical outliers, which highlights the need for more reliable data before a decision about extending the PIO for a long period is made.

ASIC has not adequately assessed other interests

In Consultation Paper 322[2] ASIC noted that "CFDs can serve legitimate trading, investment and risk purposes", however when considering the extension of the Product Intervention Order, there has been little or no attempt to assess whether the suite of conditions ASIC proposes to extend takes into account these interests.

In its consideration of significant detriment, ASIC should take account of the various categories of retail investors, including those who benefit from trading CFDs and those who under comparable jurisdictions would qualify as sophisticated investors.

ASIC should consider the consequences for sophisticated clients if the threshold for classification as wholesale clients changes.

The concept of retail clients is significantly broad under Australian law, covering all 'clients that are not wholesale clients'.[3] While Australian law includes a sophisticated investor test,[4] this test is not comparable to sophisticated investor tests in other jurisdictions e.g. the Professional Client test under MiFID II.[5] This has the effect of categorising clients under Australian law as retail clients although based on their expertise, experience and knowledge they may be treated as professional clients in overseas jurisdictions.

ASIC's PIO effectively treats all clients that come within the retail client test and trade CFDs as having suffered or are likely to suffer significant detriment and requiring the protection of the conditions of the proposed product intervention order.

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[2] CP 322.86

[3] Section 761G of the Corporations Act.

[4] Section 761GA of the Corporations Act.

[5] Annex II, MiFID II.

We respectfully suggest that a review of the industry practice with respect to the reclassification of retail clients as wholesale clients is conducted and that ASIC provides some guidance as to how CFD providers can practically satisfy the sophisticated investor test.

Requests for high leverage from Clients

After the introduction of the PIO, Australian CFD providers received a material increase in the number of clients requesting to opt-out of the leverage restrictions or tailor the leverage levels. Others requested to be reclassified as professional investors/wholesale clients, however only a very small proportion of clients who made such requests were eligible.

Trading CFDs with leverage allows clients to trade with smaller amounts at risk when compared to traditional markets. When you factor in negative balance protection (which Plus500AU has offered since inception) and other tools clients can use to manage losses e.g. guaranteed stop orders, we consider that clients are able to adequately manage the risk of losses when trading leveraged products.

CFDs have also provided greater access to retail traders to financial markets and helped reduce the overall costs of access to these markets. Spreads in markets such as FX, Indices and Commodities have been vastly reduced and CFD providers charge little, if anything, for access to margin. This gives rise to much lower execution costs for retail traders.

Whilst reducing overall leverage levels might reduce or slow down client losses, we believe that clients are well aware of both the advantages and disadvantages of leverage and actively seek leverage levels appropriate for their individual investment strategies. The reduction in overall leverage has the effect of forcing retail traders to risk much larger sums as initial and maintenance margin requirements have been substantially increased.

CP 348.15 and 348.16 acknowledge the impact the margin close-out measures and negative balance protection had on reducing client losses. Data collected from 13 CFD providers suggests that measures like the negative balance protection and margin close-out rule on an account-wide basis served the purpose of managing clients' risk of loss as they limit the exposure (and consequently the loss) of the client without limiting the client's potential gains.

It is Plus500AU's experience that investors trading with leveraged financial instruments are seeking to take advantage of trading opportunities as they arise, without having to raise a significant amount of cash by divesting their existing investments or from other sources.

Furthermore, consumers who desire higher leverage limits than those currently offered by CFD providers are likely to seek access to cash reserves in an effort to maintain their desired exposure levels.

Client vulnerability addressed by the Design and Distribution Obligations (RG 274)

One of the arguments put forward in CP 322 was the protection of vulnerable clients, particularly during the COVID-19 pandemic. Importantly, this point is not echoed in CP 348 and it would be interesting to find out whether ASIC believes that this is better addressed by employing a different approach or different measures.

We agree with ASIC that the protection of vulnerable individuals should be a priority, especially in the context of high-risk financial products and services. However, we believe that this can be achieved more efficiently at account level rather than imposing blanket restrictions which inhibit an otherwise healthy OTC market.

The design and distribution obligations are intended to help consumers obtain appropriate financial products by requiring issuers and distributors to have a consumer-centric approach to the design and distribution of products. The obligations require issuers and distributors to develop and maintain effective product governance arrangements across the life cycle of financial products. This will result in improved outcomes for consumers of these products, irrespective of the extension of the PIO.

Plus500AU argues that ASIC's use of its product intervention powers to protect retail clients against significant detriment can be achieved by using a measured approach, (considering the interests of all clients) when using its powers, so that it does not unduly impact the Australian CFDs industry and all their retail clients.

In addition, the existing Australian regulatory regime has extensive measures in place to protect retail investors who may be at risk of suffering significant detriment, including the requirement for licensees to provide their financial services efficiently, honestly and fairly.

Plus500AU's responses:

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 Product Intervention Order sunsets)?

No, for the reasons explained above. The extension of the PIO for a period of 10 years is not warranted by the data ASIC attempts to rely on when making this proposal. The data is collected over periods of time which are completely different in terms of market conditions.

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.

To a certain degree yes, but this can be attained by employing other measures such as negative balance protection, strict suitability assessments and compliance with the design and distribution obligations, which do not have unintended consequences. A measured approach, which considers the interests of all retail clients, not only vulnerable clients, would be more appropriate and fair.

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?

The only part of the PIO which we do not agree with is the maximum levels of leverage applied to all retail accounts.

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Plus500AU has offered negative balance protection to clients since inception as a way of ensuring that clients cannot lose more than the available balance in their trading account. We do not intend to change this policy.

In addition, Plus500AU has efficient processes in place to assess the suitability of CFDs to retail clients and to ensure that it only accepts applications from individuals who are experienced and knowledgeable and who are willing to and can afford the risk of incurring losses while trading CFDs.

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?

Putting aside the considerable costs of implementation (as specified in the response to ASIC's request for information), the PIO continues to negatively affect CFD issuers' financial situation (decimated revenues, increased legal and compliance costs, high R&D maintenance costs, etc). The vast majority of CFD providers are reliant on spread revenues. The significant reduction in spreads has had the effect of substantially lowering volumes traded and therefore revenues generated by turnover.

In recent years, the costs of attracting and retaining skilled compliance staff has increased exponentially. In addition, the recent changes in the CFD sector and the uncertainties associated with this industry are making operating in this industry substantially harder.

CFD issuers have also faced difficulties sourcing adequate PI insurance cover, because they have been deemed by the regulator as high risk, detrimental to consumers and managed by unconscionable and unscrupulous executives.

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?

As noted above, the dramatic reduction in spread generated revenues, the associated costs of maintaining a highly skilled compliance and legal team have escalated with the introduction of the PIO, along with the other reforms introduced in 2021.

Plus500AU welcomes the opportunity to provide further information or clarifications on any of the matters raised in this CP 348 response and we remain open to ongoing consultation with ASIC.

Kind Regards

[redacted]

Sean Murphy [redacted]
Chief Executive Officer
Plus500AU Pty Ltd