IG MARKETS

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13 June 2012

Manager, Financial Markets Unit
Corporations and Capital Markets Division
The Treasury
Langton Crescent
PARKES ACT 2600

(sent by post and via email to: financialmarkets@treasury.gov.au)

To whom it may concern,

IG Markets Limited – Response to Consultation Paper: Implementation of a framework for Australia's G20 over-the-counter derivatives commitments (the "CP")

IG Markets Limited is grateful for the opportunity to respond to the CP and to provide its comments on the proposed legislative framework.

1. IG Markets Limited ("IGM") and Contracts for Differences ("CFDs")

By way of brief background, IGM deals in over-the-counter ("OTC") CFDs on a broad array of financial instruments to a predominantly retail client base. IGM is regulated by ASIC and is a holder of an Australian Financial Services Licence, no. 220440.

As you will be aware, the provision of OTC CFDs to a retail client base in Australia is a highly regulated activity with an enormous number of legal requirements. In the last eighteen months alone the regulatory environment surrounding the provision of OTC CFDs has been impacted by numerous Consultation Papers, Regulatory Guides and other legislative reform that all have the underlying purpose of strengthening the financial requirements of providers, improving disclosure and better protecting the end investor[1].

In the context of this CP and eventual scope of the regulations to be made, please note that the CFDs that IGM offers its clients are:

- small in size;
- bilateral (enforceable only between IGM and the client);
- not traded on any exchange;
- not cleared through any central counterparty; and
- not fungible among other CFD providers.

IGM has two sides to its business; the retail client side described above and a market facing side where IGM enters into contracts with other financial counterparties in order to hedge and manage risk relating to its retail client activity. Most notably, it is our view that *neither* IGM nor any of its customers are systemically important.

[1] For example, CP146 and the final RG227 (OTC CFDs: Improving disclosure for retail investors); CP156 (Financial Requirements); CP153 (Assessment and Professional Development Framework); Treasury's FOFA reforms regarding Wholesale and Retails Clients as well as conflicted remunerations structures; CP167 and the final RG234 (Advertising financial products and advice services).

Australian Financial Services Licence No. 220440
Incorporated in England ABN 84 099 019 851

For further information about IGM please see the enclosed annex, which provides a short summary of our business and our corporate group.

2. Executive Summary

A. As noted within the CP itself, IGM agrees that consistency of implementation of the G20 commitments across jurisdictions will be critical;
B. IGM supports the staggered approach being taken by Treasury whereby the first step will be to establish a legislative framework that does not, of itself, introduce further requirements but which creates a mechanism by which such obligations may be implemented;
C. Once such obligations are consulted upon and implemented, as IGM operates in Australia as a branch of its London head office, IGM is very keen to ensure its (eventual) obligations in Australia dovetail with those implemented in the UK and that there is no unnecessary and prejudicial duplication of the same;
D. In terms of the contents of the regulations, the entities who may be bound and the classes of derivatives that may be subject to the same, IGM strongly submits that OTC CFDs offered to retail clients should not be subject to central clearing as they are not standardised products. In addition, it is our view that the parties involved in those transactions and the size of those transactions do not pose any systemic risk to the market;
E. IGM notes in respect of its own largely retail client base that the effect of many of the proposed changes would mean significant increased costs being passed on to retail clients that may detrimentally impact on those clients being able to participate in the OTC derivatives marketplace;
F. IGM's hedging of its retail business does not pose any systemic risk because it is undertaken for the sole purpose of managing market risk and exposures which in turn benefits end clients in providing a reliable and stable OTC derivatives provider. In addition, this hedging is small in size in comparison to the size traded by institutional entities. IGM submits that this business should not be caught by these legislative reforms; and
G. In respect of trade reporting, IGM requests that account is taken of the potential need to implement system changes and that obligations are consistent (both in terms of derivative classes and reporting fields) with those put in place worldwide, in particular in the UK and Europe. Ideally IGM asks that trade reporting be able to be carried out by their head office in a centralised manner for all global branches.

3. General Comments on the proposed G20 Reforms

We have reviewed the CP and have the benefit of having also been able to read, consider and respond to various other international consultations on the same G20 OTC derivatives commitments, in particular those taking place in the United Kingdom and Europe, in Singapore and in South Africa.

This legislative reform is targeted, due to their systemically risky nature, at the limited number of institutions responsible for the vast majority of derivatives trading worldwide. It is not targeted at IGM, who deals in small size CFDs to a retail client base who already benefit from significant layers of regulatory protection. Because of the enormous difference between IGM's business and client base from the intended targets of these G20 reforms, IGM is extremely concerned that it may become subject to requirements that are disproportionately detrimental to its business and would only be of minimal benefit in limiting the systemic risk issues at which these reforms are aimed.

For example, if IGM were forced to clear their retail CFDs via Central Counterparties ("**CCPs**"), this would:

- require a CCP to accept clearing a bilateral and non-fungible product;
- significantly increase our costs of doing business;
- substantially change the nature of the product offered to our clients; and

- increase the cost at which products could be offered to clients without providing those customers with any tangible benefits.

We do not believe that subjecting IGM to the clearing obligation brings material benefits to either customers or the financial system because:

- IGM already requires its' clients pay initial and variation margin when opening trades;
- IGM already segregates clients' money[2] from its own funds, therefore fully protecting customers in the case of it defaulting;
- In Australia as well as in the UK and its other countries of operation, IGM is already subject to significant conduct of business regulation, which ensures that retail customers are protected to a much greater extent than institutional customers; and
- In the UK IGM is subject to the Capital Adequacy Directive and is required to hold substantial capital, which provides additional safety for customers and robustness and support to the financial system as a whole.

We are of the view that the costs of applying the proposed clearing obligation to IGM's business far outweigh any potential benefit of doing so. Therefore, we ask that the OTC derivatives that we enter into with our retail clients should be exempted from any proposed clearing obligations.

4. Responses to specific issues and questions

IGM sets out its specific responses to the questions posed in the CP below. Due to both the volume of questions and the number of responses you are likely to receive, we have limited our comments to those questions that directly impact IGM or where we wish to specifically respond to a question.

Part B: Legislative framework

(1)	**Do you have any comments on the general form of the legislative framework?**
(2)	**Do you have any comments on the definition of "transaction"?**
(3)	**Do you have any comments on the definition of party?**

IGM's primary concern in relation to all of the matters above is the importance of cross-border regulatory harmonisation and preventing unnecessary duplication of regulatory obligations on entities such as IGM. However we also note Treasury's awareness of such matters and that the intention of this CP is not to resolve the same. We appreciate that we will be granted the opportunity for further consultation on such matters in the future when all parties are able to better assess international developments.

The definition of party is appropriate however we consider that transactions entered into by natural persons should be exempt from the proposed obligations. In addition, exemptions should be permitted for intra-group transactions and for transactions that by their nature are intended to reduce risk (such as hedging). This is discussed in further detail later in our response to Part C Section 4.

[2] Please note that IGM segregates client money (including margin) on an equity basis, being the amount which IGM would be liable to pay to that client (or the client to IGM) in respect of his CFDs if each CFD was liquidated at IGM's then quoted closing rate. In other words, IGM segregates client money taking account of running profits and losses.

(5) Do you agree that non-discriminatory access requirements should be imposed on eligible facilities?

If central clearing is to become a mandatory requirement even for small sized retail OTC derivative trades then our answer to this question is yes. In our view, if access rights are not guaranteed then there is a real risk that eligible facilities would not accept the small scale non standardised retail oriented business of businesses such as IGM.

That said, and as noted throughout this response, our preference is that retail OTC CFDs are not subject to mandatory central clearing. To do so would result in higher costs for end users resulting from the charges imposed by central counterparties.

Please also see the additional information noted below in our response to question 17 that is relevant to this subject.

(7) What should be the minimum period of consultation imposed on ASIC in developing DTRs?

As with all significant changes in legislation, an appropriate period of consultation should be conducted to permit industry to convey their views to Treasury and for industry bodies to discuss the proposed DTRs with Treasury. In our experience, a consultation period of 3 months would be appropriate.

(8) What should be the minimum period of notice between when a DTR is made and when any obligations under the DTR commences?

Taking steps to comply with a DTR can require firms to invest in costs and implement new systems and controls. In addition, firms may be required to negotiate and enter into arrangements with third parties (such as becoming a member of a trading venue or entering into arrangements with a CCP). As a result, we would recommend that at least a 9 – 12 month period would be suitable to allow firms to take steps to adhere to a DTR in an orderly fashion.

(9) Although the possible counterparty scope is set broadly, should minimum thresholds for some or all types of counterparty be set by regulation, so that no rule that is made will ever apply to those counterparties (unless the regulation is subsequently changed)?

IGM is strongly of the view that there should be minimum thresholds, or alternatively specific exemptions, regarding the types of counterparty that are subject to this regulation. We believe that this is warranted to avoid the increase in costs in providing and offering retail OTC CFDs if this regulation was applied to those parties and transactions, which pose no systemic risk to the financial system. We do not consider that there is sufficient benefit from applying this regulation to those parties and transactions.

(10) From the point of view of your business and/or of your clients, do you have concerns around any 'back loading' requirements? For example, are there any problems with obligations applying to transactions that are outstanding at the time the rule is made?

There would be an added cost in being required to "back load" eligible transactions. If it was determined that this was required, it would be important to ensure that a sensible timeline is applied to allow for this to be performed in an orderly fashion and not to impose undue obligations on firms, thereby allowing them to continue to focus on operating and managing their businesses.

Part C: Section 4.2: Trade Repositories

(13) Are there specific classes of entity that should be excluded from the potential reach of trade reporting DTRs?

(13.1) What metrics should be used to determine any thresholds?

(13.2) What should be the thresholds of these metrics that trigger when an entity may be subject to trade reporting rules? Should this threshold vary depending upon the nature of the entity?

(13.3) What is an appropriate threshold to exempt end users from the mandatory obligation to report OTC derivatives transactions to a trade repository or regulator?

(14) Do you agree with the option of including a broad range of transactions in the mandate to report trades? If not what option do you prefer?

(14.1) Are there specific classes of transaction that should be excluded from the potential reach of trade reporting DTRs?

As stated above, we consider there would be undue burden and costs involved in requiring transactions with retail counterparties to be reported. As such, we request that trades with natural persons be exempt from the reporting DTRs. In addition, we suggest that trades between entities only be required to be reported if a trade is individually above a threshold or cumulatively above a threshold over a prescribed period of time. In addition, we do not consider that intra-group transactions should be subject to this requirement provided that any market facing trades are reported, as this would be repetitive, costly and not of benefit to regulators. It is our view that our above proposals provide the appropriate balance between providing the necessary data for regulators and not imposing undue burden or costs on participants in the OTC derivatives market. We also submit that this will limit the data provided to regulators to a level which is useful and not inundate the trade repository with excessive information.

In respect of all of the trade reporting questions noted above, IGM reiterates the importance of aligning all such obligations on a global basis. Using IGM as an example, if these reporting obligations are consistent (both in terms of derivative classes (including any exemptions) and reporting fields) with those put in place in the UK and Europe then IGM can be far more confident of its ability to quickly, efficiently and accurately comply with the same.

As a branch of its UK based head office, IGM also asks that trade reporting be able to be carried out by their head office in a centralised manner for all global branches. The administrative efficiencies of enabling this would be significant. Please also note that depending on the precise scope of trade reporting requirements, parties may need to implement operational system changes so that they are properly equipped to ensure compliance with the same. This necessitates a reasonable amount of lead in time so that impacted parties are able to make the necessary preparations.

Part C: Section 4.3: Central Clearing

(16) Do you agree with the option of relying upon market forces and a range of other mechanisms, such as capital incentives, while monitoring the impact of such mechanisms in systemically important derivative classes and providing for possible future mandating, to ensure that central clearing becomes standard industry practice in Australia within a timeframe that is consistent with international implementation of the G20 commitments? If not, is there another option you prefer?

On the assumption that OTC CFDs offered to retail clients or which fall below a certain value will not be considered systemically important and therefore are not subject to the mechanisms noted above, then we have no preference for the option selected to move the wholesale derivatives industry towards central clearing. Our primary concern is

to ensure that retail OTC CFDs such as those offered by IGM do not become subject to the proposed central clearing requirements thereby causing unwarranted additional requirements and costs to providers and retail clients.

It should be noted that retail CFD firms are already subject to significant regulatory restrictions and capital requirements. Unlike institutional OTC derivative business, we have never been subject to light regulation and we have functioning procedures in place to manage our risks from clients and to brokers. We believe that these measures, in addition to the full segregation of client money that IGM applies, are sufficient to properly address counterparty risk.

If our assumption is incorrect and the retail CFD industry is subject to central clearing, we would prefer to rely upon market forces.

(17) Are there specific entities that should be excluded from the potential reach of central clearing rules?

(17.1) What metrics should be used to determine any thresholds?

(17.2) What should be the thresholds of these metrics that trigger when an entity may be subject to trade clearing rules? Should this threshold vary depending upon the nature of the entity?

(17.3) What is an appropriate threshold to exempt end users from the mandatory obligation to clear OTC derivatives classes?

Yes. As we have already noted in response to questions 13 and 14, we are of the view that OTC CFDs where at least one party is a natural person should not be considered systemically important and should be excluded from the obligations proposed under this regulation, including central clearing. In addition, we suggest that trades between entities only be required to be reported if a trade is individually above a threshold or cumulatively above a threshold over a prescribed period of time. It is our view that this would provide the appropriate balance between limiting systemic risk and not imposing undue burden or costs on participants in the OTC derivatives market.

Aside from the costs that IGM (and its clients) would bear if the requirement for central clearing of all trades became law, the practicalities of such a suggestion are problematic in many respects. As you are aware, the CFDs offered by IGM are non-standardised contracts offered on a large array of underlying instruments and often in very small sizes. We also note:

- There is currently no CCP that clears retail CFDs.
- Even if a CCP agreed to clear retail CFDs, there is no guarantee that the CCP would clear the business of all firms in the industry, or clear all contracts offered by those providers.
- It is unlikely that any CCP would want to clear retail CFD contracts as it unlikely to be financially or operationally viable for the CCP without requiring a significant increase in the costs of those products to retail clients.

In the UK, firms who deal CFDs with retail clients are already required under MiFID to fully segregate client money. In Australia this requirement is not yet law although IGM has fully segregated all client money[3] in Australia since it commenced business here and intends to continue to do so regardless of whether the law requires it. IGM has also been lobbying for full client money segregation to become law for several years and we have every expectation that it will in due course. Client money segregation gives clients effective protection against the counterparty risk of their CFD provider.

[3] Please note that IGM segregates client money (including margin) on an equity basis, being the amount which IGM would be liable to pay to that client (or the client to IGM) in respect of his CFDs if each CFD was liquidated at IGM's then quoted closing rate. In other words, IGM segregates client money taking account of running profits and losses.

Making retail CFD providers subject to central clearing rules would be a more costly and potentially less effective means of managing this risk. The benefits of central clearing of the retail CFD industry to the financial system as a whole are minimal because, as noted above, it is our view that neither IGM nor the retail CFD industry poses systemic risk to the market.

(18) Are there specific classes of transaction that should be excluded from the potential reach of trade clearing DTRs?

(18.1) In particular, should some transactions entered into for certain purposes (for example, hedging, commercial risk mitigation) be outside the potential reach of the rule-making power?

We strongly support the exemption of transactions that are entered into by entities for the purposes of hedging and risk mitigation and intra-group transactions. To add costs and complexity to such transactions may have the effect of companies opting for less effective risk mitigation which would in turn pose downstream risks to retail consumers and the financial system. In IGM's case, central clearing would add significant costs that would be passed on to clients.

(19) Do you agree with the option of requiring central clearing for derivatives where at least one side of the contract is booked in Australia and either: (a) both parties to the contract are resident or have presence in Australia and are entities that are subject to the clearing mandate; or (b) one party to the contract is resident or has a presence in Australia and is subject to the clearing mandate, and the other party is an entity that would have been subject to the clearing mandate if it had been resident or had a presence in Australia? If not, what definition do you prefer?

IGM's operations in Australia are as a branch of its London based head office. For many operational reasons including global economies of scale and in-house risk monitoring expertise, all of IGM's hedging, including for its Australian based client transactions, is carried out in the UK and is subject to EU financial regulation. IGM's primary concern therefore is to ensure that any regulatory requirements that come into force in Australia take into consideration potential jurisdictional overlaps and do not require duplicated compliance or costs, significant reporting burdens or a major overhaul of its operational processes.

Part C: Section 4.4: Trade Execution

(20) Do you consider that there are any OTC derivative classes for which an execution on trading platforms mandate would be appropriate at this time? If so, please provide any evidence which supports your view.

(21) Alternatively, do you agree with the option of applying the same approach to prescribing entities, transactions and derivative classes as has been applied for mandating clearing?

(22) If a derivative class is prescribed for mandated use of CCPs should it also be mandated for execution on a trading platform?

(23) Do you agree with the option of initially excluding the same entities and transactions from the mandate to execute trades on trading platforms as those for the mandate to clear through a CCP? If not what option do you prefer?

(24) Do you agree with the option of using the same definition of a transaction in Australia for the purposes of mandating executing a trade on a trading platform as for mandating clearing transactions through a CCP? If not, what definition do you prefer?

We believe that it is too early in the consultation process to be able to answer these questions properly. There are too many uncertainties about which providers, products and transactions the DTRs may apply to and how.

We do not believe that it is logical that derivatives mandated to be cleared should necessarily also be mandated for execution on a trading platform. This should be determined on a class by class basis.

In principle, we agree with initially excluding the same entities and transactions from the mandate to execute trades on trading platforms as those for the mandate to clear through a CCP. Similarly, that the same definition of a transaction in Australia should be applied for the purposes of mandating executing a trade on a trading platform as for mandating clearing transactions through a CCP.

Part C: Section 5: Trade Repositories

(25) From the point of view of your business and/or that of your clients, do you have concerns with reporting Australian trades to Australian and/or international trade repositories?

(25.1) What restrictions should there be on the disclosure of reported data by trade repositories? What requirements should be imposed in relation to data protection and privacy?

(25.2) What restrictions should there be on the use of reported data by trade repositories?

(25.3) What restrictions should there be on the sharing of trade repository data between TRLs; and on the sharing of trade repository data between regulators (both domestic and international)?

(25.4) Should the prices and sizes of individual transactions reported to trade repositories be made publicly available? If so, do you have any views on the time frame in which the information should become publicly available? Should there be different time periods for public release of transaction data depending on the size of particular transactions?

IGM is already required to carry out transaction reporting in the UK where we report all client and hedging transactions, including those entered into with Australian clients, to the FSA. IGM has no objections to reporting all CFD trades in this manner.

In terms of the appropriate restrictions there should be on the relevant disclosures, we believe they should be devoid of personal information or any other information that can identify an individual client or counterparty. In other words, that such reporting should comply with current restrictions on data protection and privacy.

Transaction reporting data should only be publically available if it is systemically important or considered to be relevant information for the market. Provided such data is limited accordingly, is reported in a neutral and de-personalised basis and provided it is only to be used according to the parameters set out at section 5.2.1 of the CP (e.g. risk management, public reporting of trade data), then we have no further views on the restrictions on data sharing between TRL's, either internationally or domestically.

(26) Would Australian market participants support a domestic trade repository as an alternative to an international trade repository, recognising there are likely to be cost implications in establishing and maintaining a domestic trade repository?

IGM would be supportive of an international trade repository over and above a domestic Australian one should the cost implications be material.

(29) Do you have any initial views on the property rights in trade information passed to trade repositories?

The information should be stored as data owned by the market participant who disclosed that data. No fee should be charged to a market participant (or other party to which that data relates) for accessing their own data in a trade repository. This should be one of the rights of firms adhering to its trade repository obligations.

Part C: Section 6: Anticipated Consultation Process

(31) Do you agree with the factors identified in section 6.2 for ongoing derivatives markets assessments? (32) Are there other factors that should also be included?

Other factors in addition to those listed that we believe should be considered for ongoing derivatives markets assessments include the level of product standardisation and the severity of impact on the relevant participants, both in relation to the cost impact and increased compliance burden.

5. Summary

In our response above, in addition to our specific answers to the questions posed, we have tried to emphasise the following matters:

A. The retail CFD industry is very different to the wholesale/institutional derivatives market:
   - the risks posed to the financial system are different;
   - the operational arrangements are different;
   - the rules regulating conduct are different; and
   - the market participants are different.

B. Because of the differences between the retail and wholesale derivatives industries, the costs of some of the proposed reforms if imposed on IGM and other retail CFD providers will be very high, while it is our view that the benefits to both the retail users of the CFD industry and the financial system as a whole will be minimal.

For all of the reasons set out above, we believe there are strong regulatory and policy arguments for excluding the retail CFD industry from the scope of any future requirement for mandatory central clearing.

We would be very happy to discuss the issues raised in this response in further detail at any time, either in person or by telephone. If you have any questions about this response please do not hesitate to contact me personally on the details set out below.

Yours faithfully
IG Markets Limited

Tamás Szabo
Head of IG Markets: Australia and Asia Pacific

ANNEX: SUMMARY OF IG MARKETS LIMITED

Introduction

IG Markets Limited ("IGM") deals in Contracts for Differences on a broad array of financial instruments. IGM was formed in the UK under the laws of England and Wales where it is regulated by the Financial Services Authority. IGM is also registered as an overseas company in both Australia and New Zealand where it is regulated by ASIC and the Financial Markets Authority respectively.

IGM and the IG Group

IGM is a member of the IG Group, which was established in 1974 in the UK. IG Group Holdings plc is the ultimate holding company of the IG Group and, in May 2005, its shares were listed on the London Stock Exchange. IG Group Holdings plc's market capital is currently approximately £1.6 billion and it is a FTSE 250 company. The IG Group has offices in London, France, Spain, Portugal, Germany, Italy, Sweden, the United States, Japan, South Africa, Luxembourg, The Netherlands, Australia and Singapore. It also has a Representative Office in China and employs approximately 1,000 people worldwide.

IGM's products

The core business of IGM is trading CFDs. As Treasury will be aware, a CFD is a form of derivative that is, in essence, an agreement to exchange the difference in the value of a particular financial instrument between the time at which a contract is opened and the time at which it is closed. IGM offers CFDs on a range of underlying markets including stock indices, individual shares, commodities, FX, interest rate products and options.

IGM's regulators

IGM's primary regulator is the Financial Services Authority in the UK. As noted above IGM also holds an AFSL in Australia where it has been in operation since 2002. IGM has applied for EU regulatory passports to provide services from branches in Germany, France, Italy, Spain, Portugal, Sweden, Luxembourg and the Netherlands and is subject to conduct of business supervision by the regulators in those European countries. Other IG Group companies are regulated by the CFTC in the US, the Financial Services Agency in Japan, the Financial Markets Authority in New Zealand, the Financial Services Board in South Africa and the Monetary Authority of Singapore.

More information about IGM and IG Group

IGM's website (www.igmarkets.com.au) contains a description of our CFDs, the range of markets offered, explains our online dealing platforms and provides examples of the way in which our products work. The site also contains our standard product disclosure notice, customer agreement and application forms.

The IG Group's corporate website (www.iggroup.com) contains further information about the IG Group of companies, including copies of our most recent report and accounts.