Manager
Financial Services Unit
Financial System Division
The Treasury

Email: ProductRegulation@treasury.gov.au

15 August 2018

Dear Sir or Madam,

Response of IG Markets Limited ("IG") to the revised exposure draft of the *Treasury Laws Amendment (Design and Distribution Obligations and Product Intervention Powers) Bill 2018*

We are grateful for the opportunity to respond to the consultation on the revised exposure draft of the *Treasury Laws Amendment (Design and Distribution Obligations and Product Intervention Powers) Bill 2018* ('the Bill') and to provide our comments.

1. IG

By way of brief background, IG deals in securities, managed investment schemes , margined foreign exchange and over-the-counter ("OTC") contracts for difference ("CFDs") on a broad array of financial instruments to a predominantly retail client base. IG is regulated in Australia by the Australian Securities and Investments Commission ("ASIC") and is a holder of an Australian Financial Services ("AFS") License (No. 220440).

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

2. Executive Summary

IG firmly believes in robust and proportionate regulatory oversight of financial products and services in Australia. We fully support initiatives that are designed to strengthen consumer protections and welcome the introduction of design and distribution obligations for entities that issue or distribute financial products. We appreciate that the Treasury has carefully considered submissions in response to the previous exposure draft released in December 2017 and has made a number of amendments, some of which have addressed the majority of our concerns raised previously.

While we wholeheartedly support the majority of the proposals in the revised draft of the Bill, we provide below additional comments which we hope Treasury will consider. These comments are further considered below when addressing the revised draft legislation:

- Greatest focus should be given to the suitability assessment that firms are required to apply to potential clients. By raising the bar to accessing particular products through additional guidance,

in particular requiring firms to reject inappropriate clients, firms will be naturally incentivised to market more responsibly and to a narrower target market. This in turn should greatly reduce incidents of significant harm.

- ASIC needs to distinguish between different risk profile of consumers when determining whether a loss is 'significant'. The scale of detriment should be measured against the threshold of 'significant harm' on a market-wide basis and this should be explicitly reflected in the legislation.

- It is important that the industry is given ample opportunity to voluntarily change behaviours without ASIC formally exercising product intervention powers. Furthermore, transparency in ASIC's assessment of 'significant harm' is essential in order for the industry to have a common and clear understanding of the circumstances in which ASIC may exercise its product intervention powers. Regulators across Europe remain unable to articulate acceptable client loss rates for CFDs - this lack of clear guidance has been counterproductive to the effort of addressing concerns and has led to disproportionate leverage restrictions being imposed. As a consequence, more and more consumers are moving their accounts offshore.

- In considering whether detriment resulting from a financial product constitutes 'significant harm', ASIC should be required to take into account whether the detriment was caused by AFS licensees or by unlicensed brokers. The latter are typically offshore brokers who will continue to inflict detriment on Australian consumers irrespective of whether the product intervention rules are in place. We are concerned of the consequences of a one-size-fits-all approach in which responsible firms are adversely impacted due to the actions of a small number of bad actors. In particular, we are concerned that a disproportionate approach will inevitably lead to Australian consumers moving their business to product distributors and issuers in offshore, unregulated jurisdictions, thereby losing the protections afforded by Australian financial services regulation. This is something clearly evident in Europe and is something that IG is tracking closely. We would welcome to share our findings with you once our sample size is sufficiently robust to draw initial conclusions.

3. Submissions

Section 1023E: Significant detriment to retail clients

We note that the absence of a definition of 'significant' in the revised draft is intentional at this stage. Paragraph 2.31 of the EM states that "*the meaning of significant is intended to take its ordinary meaning in the context of the new provision*". Paragraph 2.33 further states that "*ASIC can take into account a range of objective and subjective factors in determining whether a loss is significant. For example, objective factors could include the number of consumers affected and the total amount of the detriment. Subjective factors could include the impact of the detriment on the consumers affected by it*". Whilst we agree that the extent of consumer detriment can partially be determined by reference to the objective and subjective factors referenced, we believe that the risk profile of consumers affected should also form the basis for determining the extent of consumer detriment.

The risk profiles of consumers undoubtedly vary across different product types. Consumers who invest in leveraged trading products have very different risk appetites compared to consumers who invest in non-

leveraged products, such as shares. Transparency in ASIC's assessment of 'significant harm' is therefore essential as it ensures that any intervention is based on accurate information and promotes a common and clear understanding amongst industry of the circumstances in which ASIC is minded to exercise its product intervention powers. The scale of detriment should also be measured against the threshold of "significant harm" on a market wide basis and this should be explicitly reflected in the legislation.

CFDs are typically used to take short term speculative views on market movements, rather than to make long term investments. In contrast to the case where assets are bought and held as investments for months or years, there is no meaningful interest income or dividend yield from a CFD position held for a number of hours or days. In other words, short term trading (using CFDs, or any other analogous product, such as futures or options) is a zero sum game – in the absence of transaction fees, the net P&L of all short term speculative traders is zero, with profits of successful traders balanced by the losses of unsuccessful traders. However, the fact that trading is not free of costs leads to the typical results seen for all short term speculative products – including CFDs – where the average trader P&L is a loss equal to the sum of transaction fees paid, and where the majority of traders lose. For CFD traders, results vary across firms (and preferred underlying asset classes) but typically 75-80% of traders tend to lose, and 20-25% of traders tend to win (over an annual time horizon). However, provided that this population of CFD traders is made up exclusively of individuals who (a) have an appropriate level of knowledge and understanding and financial standing; and (b) have a risk profile consistent with trading a short-term speculative leveraged product, these loss rates needn't necessarily be indicative of poor consumer outcomes[1]. In particular, if consumers are realistic about the likelihood of being profitable[2].

While we welcome many of the design and distribution obligations, in particular the measures aimed at defining appropriate target markets and ensuring that issuers and distributors appropriately market and distribute financial products, we believe that occurrence of significant harm would be greatly reduced by new detailed measures in the area of suitability testing. That is, measures that ensure that only clients of sufficient knowledge, understanding and financial means are able to access particular complex products. At IG, we are clear that CFDs are complex products that are inappropriate for the vast majority of retail clients. Our assessment of each client we on-board is therefore carefully designed to filter out those we deem to be inappropriate. Unfortunately, existing regulatory rules and guidance in this area are disproportionately weak and allow firms significant scope when making a determination of whether to accept a client, or not. As a consequence, consumers may be exposed to the risk of significant harm. In our view, greater rules and guidance in this area would naturally incentive firms to market to a sensible target market since they would be required to reject applications falling outside. This would greatly improve firm conduct whilst simultaneously protecting a large number of consumers for whom the product is clearly inappropriate.

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[1] In Europe, ESMA's CFD product intervention identifies 'significant harm' as being a high proportion of clients trades being automatically closed out due to having insufficient margin. Their leverage restrictions that are therefore intended to limit the chance of an automated margin close-out on CFD positions to less than 5%, given historic price moves in each underlying asset class and an assumed typical holding period for positions in CFDs on each underlying asset class. Limiting the chances of automated close out to less than 5% is, we think, perfectly reasonable. Unfortunately, ESMA have imposed leverage restrictions above and beyond those needed to achieve its aims. We will look to engage with ASIC on this important topic in the coming weeks and months ahead.

[2] Client survey data gathered during the ESMA consultation process strongly supports the view that clients are fully aware of the risks of losses and are realistic about their prospects of being profitable. That they make an informed decision to participate however, is of key importance.

Finally, in determining whether the detriment resulting from a financial product is significant, ASIC should also take into account whether the detriment is caused by an AFS licensee or by unlicensed offshore broker(s). The latter will continue to inflict detriment on Australian consumers irrespective of the product intervention rules in place and a market-wide ban to address the unregulated and/or offshore provider will likely have unintended consequences – e.g., accelerating the numbers of consumers taking their business to offshore, unregulated product issuers, and losing the investor protections afforded to them by ASIC and the FOS (soon to be replaced with AFCA) in the process. Early indications in Europe are suggestive of the fact that ESMA's product intervention is having precisely this effect, with EU clients taking their business offshore.

Section 1023F ASIC to consult before making product intervention orders

We note that under subsection (1) ASIC must not make a product intervention order unless ASIC has consulted persons who are reasonably likely to be affected by the proposed order. However, under sub-section (3) ASIC is taken to comply with subsection (1) if, on its website, ASIC makes the proposed order available and invites the public to comment on the proposed order. Furthermore, a failure under subsection (1) does not invalidate a product intervention order.

We believe that the consultation must be a private matter with no pre-exercise of the product intervention power and must give the affected entity reasonable opportunities to respond and to resolve the problems identified by ASIC. As such, we are concerned that ASIC's failure to comply with the consultation requirements would not invalidate its product intervention. We believe that any failure under subsection (1) should void the intervention and that the Bill be updated accordingly.

Conclusion

We welcome the ability to engage in consultations and thank the Treasury for the opportunity to be able to provide comments on the revised draft of the Bill.

Yours faithfully,

Kevin Algeo
Chief Executive Officer
Australia and New Zealand

ANNEX: SUMMARY OF IG MARKETS BUSINESS OPERATIONS

1) INTRODUCTION

IG Markets Limited ("IG") deals in securities, MIS, leveraged foreign exchange and contracts for differences (CFDs) on a broad array of financial instruments. IG was formed in the UK under the laws of England and Wales where it is regulated by the Financial Conduct Authority ("FCA"). IG is also registered as an overseas company in both Australia and New Zealand where it is regulated by ASIC and the FMA respectively.

2) INFORMATION ABOUT IG AND THE IG GROUP

2.1 IG and the IG Group

IG 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 in excess of £2.9 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, Switzerland, Dubai, Australia and Singapore. It also has a Representative Office in China and employs approximately 1,500 people worldwide.

2.2 IG's regulators

IG's primary regulator is the Financial Conduct Authority ("FCA") in the UK. As noted above IG also holds an AFSL in Australia where it has been in operation since 2002. IG has activated its EU regulatory passport and provides services from branches in Germany, France, Italy, Spain, Portugal, Sweden, Ireland, Luxembourg and the Netherlands and is subject to conduct of business supervision by the regulators in these European countries. Other IG Group companies are regulated by the CFTC in the US, the Financial Services Agency in Japan, the Financial Markets Authority New Zealand, the Monetary Authority of Singapore, the Financial Services Authority in Dubai and the Financial Markets Supervisory Authority in Switzerland.

2.3 More information about IG and IG Group

IG's Australian website (www.ig.com/au) contains a description of our securities, MIS, LFX and 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 relevant disclosure documents, 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.