

CFD Requirements Consultation
Asset Management Supervision Division
Central Bank of Ireland
New Wapping Street
North Wall Quay

Dublin 1

May 2017

Dear Sirs

CMC UK plc and CMC Spreadbet plc (“CMC”, the “**Company**”, “our”, “us”, “we”) refer to Consultation Paper 107 “Consultation on the Protection of Retail Investors in relation to the Distribution of CFDs” which we read in the context of broader global concerns and regulatory changes over the marketing and distribution of retail derivatives.

CMC is one of the world’s leading providers of Contracts for Difference (“CFDs”) to a predominantly retail focused client base. Through its Next Generation online trading platform, CMC provides access for its global client base to over 10,000 financial instruments in shares, indices, foreign currencies, commodities and treasuries. CMC operates globally through regulated offices in 14 countries, with a significant presence in the UK, Australia, Germany and Singapore. CMC has retail clients based in more than 70 countries, who are serviced through direct client relationships with CMC, as well as through partner and institutional client relationships with banks, brokers, asset managers and other professional and corporate firms.

CMC offers its products primarily under the “CMC Markets” brand name and operates its trading platform through its website “www.cmcmarkets.com” and related local-language websites, as well as on mobile platforms.

In the twelve months ended 31 March 2016, CMC had 57,329 Active Clients who had traded in the previous twelve months, and processed approximately 67 million trades in the year ended 31 March 2016. CMC offered one of the world’s first online foreign exchange trading platforms to retail clients in 1996. Since then, the Group has developed and expanded its offering to include Over-the- Counter (“OTC”) derivative trading via CFDs.

We currently operate accounts for retail clients through our MiFID passport in the Republic of Ireland and clients access our trading platform via the internet on desktop computers or mobile devices.

As a responsible financial services provider, we are committed to high standards of conduct and share many of the concerns that have been raised by the Central Bank of Ireland, the FCA, ESMA and other national regulators. We are in dialogue with many regulators in this regard.

CMC has seen rapid and significant growth in the number of firms providing CFDs. Many firms, more commonly new entrants who operate on a cross-border basis, engage in unauthorised or illegal activity (noted in the AMF’s Annual Report 2015 as being a large contributor to losses of 4bn EUR sustained by French clients over the last 6 years), and are operating outside the regulatory perimeter or with very low standards of regulatory compliance and a lack of consideration of client’s best interests. We believe that this has led to the increasing levels of poor conduct, targeting of unsuitable clients through inappropriate means and consequent risk to investor protection observed by the Central Bank of Ireland (“Central Bank”) and other relevant regulators, including ESMA.

New entrants tend to be smaller firms, relying on outsourced controls and compliance, off-the-shelf IT platforms, using a single hedging counterparty to provide execution prices and in many instances operating a matched principal model to transfer risk to intragroup entities with lower prudential requirements and tax burdens. The authorisation of such new entrants has radically amplified the risks to investor protection by raising additional conduct and prudential concerns for the regulators themselves and has exacerbated the corresponding pressure on many existing providers forcing them to compete on terms that have ultimately expanded the target market for such products and negatively impacted client outcomes. The conduct and practices of such new entrants has tarnished the reputation of well-established, compliant firms.

We note that at 2.4 and 2.5 in the consultation paper, you outline two different business models prevalent in the industry, that of “market maker” or “principal” and that of “matched principal”, noting that in the “market maker” or “principal” model, “there is a direct correlation between the client’s loss and the CFD provider’s gain”. This statement does not take into account the hedging activities of the provider. Few reputable providers take the entirety of the client trade onto their balance sheet in this manner as it exposes the provider to significant market risk, and many use risk management strategies to hedge the market risk, in whole or in part, on an aggregated basis, onto wholesale markets, with revenue coming primarily from the spread and other trading costs rather than from client losses.

We note the proposed measures and would respond to the consultation questions as follows.

Question 1

Which of the options outlined in this paper do you consider will most effectively and proportionately address the investor protection risks associated with the sale or distribution of CFDs to retail clients?

We do not believe either option as presented will effectively or proportionately address the investor protection risks associated with the sale or distribution of CFDs to retail clients.

We would wish to draw the Central Bank’s attention to research carried out by Investment Trends for the leading UK based providers of CFD products which shows, across a population of 2,722 active traders, 79% of those questioned believed that less than 30% of clients make a profit from their trading activity; this appears to be an accurate understanding across this retail client base of the risks and likelihood of profits to be derived from trading.

The same piece of retail client research suggests that clients seek to trade for “the intellectual challenge of speculating on markets” and for “the satisfaction of getting it right on a winning trade”. We have provided this research to the FCA as part of our response to CP16/40 “Enhancing conduct of business rules for firms providing contract for difference products to retail clients” and would be pleased to discuss it in more detail with the Central Bank.

We therefore believe that regardless of the measures proposed by the Central Bank, there is likely to remain a population of retail clients, well informed of the risks of trading, who will continue to seek opportunities to speculate on markets and who enjoy trading.

We would urge the Central Bank to exercise caution in their proposed intervention. We do not believe that a prohibition as per Option 1 is proportionate and we think such a prohibition would unnecessarily restrict the ability of well-informed retail clients who seek to trade and speculate on markets. We are concerned that both options will have unintended consequences including increased customer detriment and with respect to option 2, reduced competition between firms. We also note the risk of Irish retail clients seeking overseas providers, or being targeted by overseas providers, in our responses below.

Question 2a

Do you agree with the proposal to restrict leverage to 25:1 for retail clients trading CFDs?

Following the FCA's publication of CP16/40 we constructed a data model using the extensive store of market and client data that we hold and from this we have worked with the FCA to ascertain, using VaR methodology, margin levels that deliver appropriate client outcomes.

We would be happy to arrange a workshop with the Central Bank to demonstrate and discuss the methodology in detail.

If the objective of a regulatory minimum margin level is to ensure that a client position in a given instrument can survive typical market conditions for a given period without being closed out, then the table below demonstrates the high level output of our model:

	Instrument	Suggested Margin (rounded)	
		Inexperienced	Experienced
FX Pairs	EURUSD	3.00%	0.75%
	GBPUSD	2.75%	0.75%
	AUDUSD	3.25%	1.00%
	USDNOK	3.75%	1.00%
Bullion	XAUUSD	5.25%	1.25%
	XAGUSD	8.75%	2.25%
Equity Index	UK100	4.50%	1.25%
	US30	3.75%	1.00%
	ITALIAN40	10.00%	2.75%
	SPANISH35	8.50%	2.50%
Commodities	UKCRUDEOIL	11.00%	2.75%
	USNATGAS	11.75%	3.25%

This is based on implied risk appetites of those new to trading (trade survival for 12 hours for 99% of time intervals) and more experienced traders (trade survival for 2 hours for 95% of time intervals). Note the variation of margin rates across the instruments, which reflects the underlying volatility of the asset classes.

We believe that the general proposal in the Central Bank consultation paper of 4% / 25:1 is excessively restrictive for those clients who have experience of trading and an understanding of the risks associated. We believe that imposing this restriction may lead such retail clients to seek CFD providers elsewhere, outside Ireland or the EU, potentially increasing consumer protection risks.

We note that the restriction is aimed at firms who distribute or market CFD to retail clients in and from Ireland. We believe, due to the increasingly online nature of both the trading account and the associated marketing, that such restrictions and prohibitions are difficult if not impossible to adequately enforce.

Question 2b

Do you agree with the proposal that retail clients trading CFDs should not be at risk of potentially limitless losses and that firms offering CFDs should be required to put in place negative balance protection on a per position basis?

We understand the attraction of negative balance protection in giving clients certainty as to the amount of capital that is at risk. We note that it has only been in extreme circumstances, such as the actions taken by the Swiss National Bank in January 2015, that retail clients have seen losses significantly larger than the sums on balance in their trading account. Leverage is best viewed as an account level metric, and many of our clients tend to keep their accounts funded, not seeking to use all the sums deposited as the initial margin on trades. Most trading platforms are multi-asset platforms allowing clients to have a number of trades active at any given time, with sums allocated as margin in real time. For the majority of clients, should the overall value of the account equity drop to 50% of the margin requirement across all open trades, trades will begin to be close out. Clients have the opportunity at any point before this level is reached to fund their accounts with additional margin in order to keep positions open, should they wish. The automatic close out acts to protect the client from losses exceeding the amounts deposited in all but the most volatile market conditions.

The negative balance protection described by the Central Bank is available to our clients through activation of Shield Mode. This places a Guaranteed Stop Loss Order (“GSLO”) on each and every trade. The GSLO, however, has a cost to reflect the allocation of capital at the provider and therefore there is (a) a premium on the GSLO and (b) a reduction in the number of instruments that can be offered in this manner. We note that the French regulator, the AMF, has mandated that this form of account is the only one which can be marketed in France, although French retail customers can still seek to trade without this addition protection if they wish.

We note that BaFin have mandated in Germany that the negative balance protection should operate at the account level, a feature which some firms have offered for a number of years. We do not believe that this product feature demonstrably improves customer outcomes or provider conduct, although it can act to protect retail clients in the event of extreme market moves.

Question 2c

Do you agree with the proposal to prohibit all bonus promotions and trading incentives in relation to CFD client accounts?

We have observed poor conduct from many CFD providers and purported CFD providers across Europe. This conduct is characterised by aggressive marketing, often with complicated bonus offers; misleading representation of the risks and benefits of trading; use of call centre staff to aggressively sell accounts; and in the worst cases, outright fraud. This has led to wide misspelling of CFDs

We would therefore agree with the proposals in option 2 to prohibit “bonuses and other promotions”. As part of the service offered to retail clients, firms in this sector often waive market data fees for clients and we would seek clarification that this is not viewed as a “trading incentive”. In addition, certain clients who trade high volumes are periodically rebated a portion of their trading costs to reflect the economies of scale. Again we would seek clarification that returning trading costs to high volume clients is not within scope of the proposal to prohibit “trading incentives”. We are happy to meet and discuss these matters further.

Question 2d

Do you agree with the proposal to require firms offering CFDs to retail consumers to provide a standardised risk warning to clients disclosing the percentage of active retail CFD clients who suffered a loss of equity during the previous quarter and over the previous 12-month period?

We agree that a standardised risk warning on the basis set out is an appropriate requirement in this sector. We would be happy to publish this on our website and as part of the core client documentation. However, we do not think that it is practical to have it form part of “all marketing communications” given the increasing online nature of activity in this sector. This would have the potential to put Irish providers of CFDs at a general disadvantage against those from other jurisdictions advertising in digital medium.

Question 3

Are there further measures which the Central Bank should consider as part of its analysis?

Our analysis suggests that there is a population of retail clients who may not qualify as “professional” under MiFID or local regulatory requirements but who are well informed, understand the risks and are able to absorb the losses that can arise from trading. These clients may seek to trade as part of an overall investment strategy or on occasion to hedge other portfolio risks, or to take advantage of short term market conditions. In our view, this group of retail clients should be able to trade on leverage at realistic levels. We therefore suggest that a client categorisation scheme, using the existing MiFID appropriate / inappropriate categories, be employed for leveraged products, with those classed as “inappropriate” given the forms of enhanced consumer protection outlined in Option 2 (higher minimum margin requirements and some form of negative balance protection).

The Central Bank can issue detailed guidance in relation to onboarding and classification to ensure that retail clients who have insufficient assets to withstand the potential losses that can arise from leveraged products are rejected; those with little experience of knowledge of trading are treated as “inappropriate” and offered some protection and those who have both sufficient assets and experience are “appropriate” and provided with a trading account that meets their needs.

We suggest that the Central Bank also continues to warn customers of the activities of overseas operators and scams as we see this as the area of greatest continuing harm against the general public. We would be happy to consult with the Central Bank in how these warnings could be given greater prominence in the predominately digital marketing space.

Question 4

In relation to the options outlined in this paper, are there any detrimental effects on investors or the markets or unintended consequences that you consider should be taken into account by the Central Bank?

If enacted as proposed, Option 1 would clearly have a detrimental impact on both domestic CFD providers and those firms who seek to service the trading requirements of Irish retail consumers.

In addition, a prohibition would, in our opinion, result in a number of current Irish retail consumers seeking opportunities to trade with overseas providers, exposing them to the risk of decreasing levels of consumer protection and increasing risks of fraudulent operators. In the absence of any properly regulated or authorised domestic providers, Irish retail consumers are unlikely to be able to differentiate easily between legitimate and illegitimate providers.

Option 2 would also result in this risk to Irish retail consumers, as the proposed minimum margin requirement at 4% is significantly higher than that seen in many other jurisdictions, both with the EU and elsewhere. We would suggest that a level of 1% would strike the appropriate balance between direct consumer protection and dis-incentivising consumers to seek overseas providers.

Question 5

What do you consider will be the likely effect of the options outlined in this paper on investors and market participants who may hold, use or benefit from CFDs?

We have no further comments as we have articulated the potential impact on both investors and market participants.

As a general observation, we would note that following the UK's decision to leave the European Union, we had carried out an assessment of potential locations for a European Hub, and in this regard we sought to discuss both the potential for such a Hub in Ireland and to discuss some of the matters outlined above, where we believe that we can give the Central Bank further insight into the sector, retail client behaviour and technical matters. We look forward to picking up these discussions in due course.

Your faithfully,

Keith Falconer
Global Head of Compliance