

18th February 2014

Dr Richard Chadwick
General Manager
Adjudication Branch
Australian Competition and Consumer Commission
GPO Box 3131
CANBERRA ACT 2601

Email: adjudication@accc.gov.au

Re: Australian CFD Forum Limited and others – Application for Authorization A91403 and A91404 – interested party consultation.

Dear Dr Chadwick

First Prudential Markets Pty Ltd (“FP Markets”) welcomes the opportunity to comment on the application for authorisation A91403 and A91404 (“the Application”) by CMC Markets Asia Pacific Pty Ltd, GFT Global markets UK Limited, IG Markets Limited and Australian CFD Forum Limited (“the Forum”) (collectively, “the Applicants”).

It is our view that the Application seeks the endorsement of conduct which would breach the cartel provisions and the exclusionary provisions of the *Competition and Consumer Act 2010*, and which should not be approved, as the anti-competitive effect would outweigh any perceived public benefit.

1. About FP Markets

FP Markets is an Australian owned company, Australian Financial Services Licence (“AFSL”) number 286354, and has been trading since 2005. We are an active promoter of the direct market access (DMA) business model and external research conducted by Investment Trends has shown, for the past six consecutive years that we have the most satisfied clients in the industry.

Under FP Markets’ DMA model, all client orders are directly and fully hedged in the underlying market or with a liquidity provider. This means we do not take any proprietary positions and do not make money from client losses. So, unlike CFD providers who operate under the market maker (“MM”) model, our commercial interests are aligned with those of our clients.

Research conducted by Investment Trends indicates that the majority of our clients cite DMA as a reason for trading with FP Markets rather than a MM CFD provider. We are continuing to grow which indicates that there is a strong demand for DMA in Australia.

FP Markets does not take any proprietary positions. We derive all our revenues from commission and financing and do not benefit from client losses. Consequently,

our business model is focused on giving retail clients every opportunity to make money in the markets. This means it is in our interests for our clients to be as successful as possible, on an ongoing basis, so that they are far more likely to continue trading with us.

Our objection to the Australian CFD Forum is that despite being one of the oldest and most awarded CFD Providers in the industry, which is also one of the most heavily capitalised, (on a relative to liability basis), we would not be able to join to Australian CFD Forum and continue offering our DMA model, for reasons that are explained below. We believe that a likely result of the Australian CFD Forum administering industry standards will only cause confrontation in the industry which will in fact inhibit the industries ability to work together to genuinely provide higher standards for CFD clients.

2. The Application is biased towards the Applicants' business model

The Application mentions that membership of the Forum “will become a point of competitive differentiation among CFD issuers...” (page 2). We agree with this statement, but wish to explain that the requirements of the Application's best practice standards, particularly standard 7 (Segregation and protection of client money) is biased towards the business model adopted by the Applicants.

As noted above, there are currently two models for issuing CFDs in Australia — the DMA model and the MM model.

- a. Under the MM model, the CFD issuer takes opposition positions against client trades to a certain limit, and then offsets remaining positions to third parties. In order to offset those positions, it must provide some collateral to those third parties.
- b. Under the DMA model, the CFD issuer passes on every client trade to a third party liquidity provider. It must also provide collateral to those third parties.

The founders of the Australian CFD Forum have a MM business model whereby they leave many client orders unhedged to profit from clients losses. This model therefore reduces hedging requirements, which makes it easier to meet the requirements of standard 7. However, this creates a direct conflict of interest between these firms and their clients. We can provide more detailed explanations upon request.

In contrast, DMA businesses must provide collateral with hedging counterparties for all client trades. They may use their own funds or client funds in doing so. In our view, this model, whilst potentially using a degree of client funds, reduces other counterparty risks faced by MM businesses. Other advantages of DMA business model are:

- c. guaranteed market prices,
- d. no re-quotes; and
- e. alignment of interest between the CFD provider and the client

We can provide more detailed explanations upon request.

The below points illustrate practical concerns with standards presented by the applicants:

Key Risk:	CFD Provider suffers a loss from which it cannot recover, thereby eroding recoverable client money in the event of insolvency	
Model:	MM	DMA
Marketing pitch:	"We're a member of the Australian CFD forum so your funds are safer."	"We don't take positions against you to minimise counterparty risk – so your funds are safer."
Event:	Client places a winning trade with a value of \$10m.	Client Places a losing trade with a notional value of \$10m on Monday. During the night, there is an announcement that has a dramatic, negative impact on the valuation of the trade, triggering forced liquidation of the client's position. The position is closed out but the client's account is in "negative equity" in the sum of \$100,000 because the closing position gapped past the pre-set stop loss.
Loss:	MM has taken opposite position, and is therefore forced to cover the \$10m loss with its own money.	The trade was fully passed on to the DMA's liquidity provider. However, the client is rendered bankrupt so the DMA must cover the \$100,000 loss with its own money.
Standard 12:	\$2m NTA amount does not cover loss of \$10m	We always hold well in excess of the \$2m requirement, however we note that smaller DMA businesses would have a lower requirement than ourselves and would be excluded from the Australian CFD Forum even though their client positions may be very small and would require regulatory capital of less than the applicants \$2m requirement.
Standard 7	Segregation of client money does not stop the MM from suffering a \$10m loss.	Segregation of client money does not stop the DMA from suffering a \$100,000 loss. However, DMA can only back-to-back its positions with its liquidity provider (and so avoid a 10m loss as set out in the left hand column) if it places collateral with a hedging counterparty. .

While we support establishing best practice standards, in our view it is important that such standards are genuinely focused on better protection of retail clients, and not on giving a commercial gain to a minority of providers. We see this submission as an attempt to undermine the DMA model which is increasingly proving to be preferable to their market maker model.

DMA business models are becoming more popular. DMA business would be limited, for the above reasons, in becoming a member of the Forum. This means that over time, fewer players would be eligible to be members of the Forum. This move towards DMA is evident in external industry research from Investment Trends, which shows a large market share decline for market makers CMC Markets and GFT, decline of 16% and 33% respectively over the past 12 months, while more DMA/STP focused providers have shown to increase market share considerably.

We submit that allowing a group of MMs, to represent themselves as an industry body, would be detrimental to the CFD industry as clients would no longer be presented with balanced information regarding the different CFD models that exist in the market in the event that the Australian CFD Forum is a point of reference.

We submit that standard 7, requiring firms to completely ban the use of client money for hedging in all circumstances will disproportionately impact the DMA model because the DMA model has higher hedging requirements due to the fact that all client orders are hedged.

If the Forum succeeds in being a “point of competitive differentiation”, it will significantly reduce competition, thereby increasing commissions paid by clients and reducing access to many of the benefits which a DMA model offers.

3. Other effects of standards

We believe that there are a number of negative, anti-competitive, cartel-like or exclusionary effects that flow from establishing the Forum in its current form, including:

- Less attention is drawn to the differential between OTC market prices (quoted by MM businesses) from underlying financial markets prices (quoted by DMA businesses).
- To join the forum some providers may in fact need to increase their counterparty risk to join, despite clients believing that risks are reduced by Forum members. This is due to a lack of a requirement to hedge amongst forum members and that unrealised profit and loss is not necessarily being protected with a hedge order in the case of a MM business model.
- There may be increased commission costs to clients: an increase dominance of the market maker model with reduced DMA relevance will likely increase commission rates charged to clients.

- Re-quoting will increase: Before the DMA business model developed in the Australian market, MM providers re-quoted prices to clients, generally in the favour of the CFD provider and to the detriment of the client. We note there is nothing in the standards put forward to address or even mention this important issue for clients.
- Order execution speeds may slow down: DMA trades execute as quickly as a trade does on the underlying markets as there is a simultaneous back to back hedge trade to the CFD trade. There is no dealer intervention for DMA clients. If the MM business models are the dominant option for CFD clients, CFD orders are not placed directly on the market but flow through a dealer, resulting in slower trades, especially in fast moving markets and again this is not addressed in the standards proposed.
- Price transparency for clients may decrease: DMA ensures that the client trade at underlying financial products prices for their CFD trades. Under the MM model, prices are derived from the underlying market, but the MM CFD provider may add a spread.
- There may be no underlying market liquidity for clients: DMA providers hedge 100% of client trades in the underlying market; this means the liquidity of the underlying market is reflected in the liquidity of the DMA market. The client has complete transparency to the underlying market and can monitor their trades being executed by volume and price.
- Clients of Forum members may be unable to participate in all market phases. DMA providers allow clients to participate in the opening and closing phases of an underlying market. MM CFD providers do not. An inability to be able to trade in the opening and closing market phases results in less liquidity for clients.
- The DMA model enables clients to be both price markers and price takers. Under the MM model, clients are price takers only. As it is often in the interest of MM for their clients to lose money, it follows that it is often in the interests of MM providers to:
 - re-quote prices to earn additional income on the spread price offered to clients;
 - close-out client positions as the provider profits from losses; and
 - deal with loss making clients.
- Standards 7 and 12, on face value, are used by the Forum to suggest that its members are “raising the bar” in terms of protecting client money. In our view, this is misleading, because client money is protected better by having strong risk management models, that vary depending on the type of business (MM or DMA). Using the example in the table above, holding \$2m in NTA would not have substantially protected the MM if it suffered a \$10m, loss due to a client’s corresponding win. Having strong risk management position limits and testing models, would have.

The many benefits of DMA highlighted above are not represented by the Australian CFD Forum. Two out of the three founding members do not offer DMA at all, with IG being the exception, however it only offers it to their more educated clients and do not promote it heavily.

4. The advantages of a Forum

We agree that there are advantages in having a forum that is representative of CFD providers who are keen on complying with the law and setting a high watermark in terms of good risk management, transparency and professionalism.

We embrace the approach taken by ASIC in terms of its guidance around handling client money, new NTA requirements and other benchmarks, and have been in ongoing liaison with Treasury about potential solutions to managing risks in the industry. We also accept the other standards suggested by the Applicants.

In our view, the rationale behind standards 7 and 12 is not to protect the interests of the client – but rather, the interests of large MM entities. Consequently, the Application has the effect of substantially lessening competition in the Australian market, and it should be rejected, or amended to address the issues raised in this letter.

We would welcome the opportunity to further discuss any matters raised in this submission or provide additional information if required.

Yours Sincerely



Matthew Murphie

Managing Director