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Department of the Senate  
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Parliament House  
Canberra ACT 2600

Email: fintech.sen@aph.gov.au

Dear Select Committee on Financial Technology and Regulatory Technology

**Re: Financial Technology and Regulatory Technology Second Issues Paper**

Pepperstone Group Limited (“**Pepperstone**” “**we**” “**us**” “**our**”) welcomes the opportunity to make an additional submission to the Select Committee on Financial Technology (“**FinTech**”) and Regulatory Technology (“**RegTech**”) (“**Select Committee**”).

As mentioned in our previous submission, Pepperstone is a global margin foreign exchange (“**FX**”) contract and other contracts-for-difference (“**CFD**”) issuer that was established in 2010 in Melbourne, Australia. Pepperstone is licensed and regulated by the Australian Securities and Investment Commission (“**ASIC**”). The Pepperstone group also now holds financial services licenses in the UK, Dubai, The Bahamas, Cyprus, Germany, and Kenya via locally based subsidiaries.

We note the Select Committee has raised several questions in its second issues paper, but we would like to focus our submission on the Product Intervention Power,<sup>1</sup> as we are in a unique position of having experienced its use. On 23 October 2020, ASIC made a Product Intervention Order,<sup>2</sup> which impacts the way our industry (the “**CFD and FX industry**”) is able to offer our products to retail investors in Australia.

We would like to provide insight to the Select Committee to assist with its considerations about ASIC’s use of that power with the view to potentially improving any future actions.

The CFD and FX industry is fully supportive of ASIC’s role in policing and encouraging responsible and reasonable regulation to both protect investors while also supporting business. Prior to any Product Intervention Order consultation announcement, a group representing a significant proportion of CFD and FX businesses in Australia approached ASIC with an Industry Code of Conduct that would have required its signatories to implement a number of product restrictions based on the International Organisation of Securities

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<sup>1</sup> s1023D *Corporations Act 2001* (“**Product Intervention Power**” “the **Power**”)

<sup>2</sup> See ASIC Corporations (Product Intervention Order—Contracts for Difference) Instrument 2020/986 (“**Product Intervention Order**”, “the **Order**”).

Commissions (“**IOSCO**”) standards, including caps on leverage, although not at the levels eventually implemented by the final Product Intervention Order.

Therefore, our position is not that the Australian financial services regime should fail to evolve to include more detailed regulation for our industry where reasonable, it is more that we are concerned the Product Intervention Power was not the appropriate power to use to implement the changes. We are concerned the use of it in this way may create concerns of uncertainty in the Australian financial services market.

We believe if the Government wants to attract new business to Australia, particularly FinTech businesses, then it is important that the Government consider moving back to the original thinking and discussions when the Product Intervention Power was first recommended in order to create a regulatory environment that not only protects investors but also supports competition, innovation and provides certainty.

### **Origins of the Product Intervention Power**

The origins of the Product Intervention Power came from the Government’s 2014 Financial Systems Inquiry (“**FSI Final Report**”).<sup>3</sup> As part of the recommendations for how the Power should be used, a number of important aspects were discussed:

1. *[The] power should be used as a last resort or pre-emptive measure where there is risk of significant detriment to a class of consumers.*<sup>4</sup>
2. *Given the potential significant commercial impact of this power, the regulator should be held to a high level of accountability for its use...The efficacy of this power depends on a strong, independent and accountable regulator. As part of its overall assessment of ASIC’s performance against its mandate, the proposed Financial Regulator Assessment Board should assess the use of this new power*<sup>5</sup>
3. *Firms with robust product design and distribution practices should not face additional regulatory costs as the focus would be on products being distributed to consumers who do not understand the central features of the products, such as risk.*<sup>6</sup>

We have reservations that the way the Power has now been implemented and used by ASIC means the outcome may have moved away from these critical considerations.

### **FSI Final Report considerations**

1. The power should be used as a last resort or pre-emptive measure where there is risk of significant detriment

This recommendation suggests that, unless there is a particularly time sensitive matter or an urgent new factor arises, ASIC should use the other options it has available to it before considering invoking Product Intervention Power. These options would clearly include consideration of additional regulatory guidance, formal law reform and taking of enforcement action against entities who are in breach of current Australian requirements.

Formal law reform does take time, but that is because all aspects of the reform are required to go through multiple consultation stages, are discussed openly, and are thoroughly considered by multiple parties. The decision-making process is very transparent, and the

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<sup>3</sup> See Financial System Inquiry Final Report Recommendation 22 *Introduce product intervention power* <https://treasury.gov.au/sites/default/files/2019-03/p2014-FSI-01Final-Report.pdf>

<sup>4</sup> Ibid.

<sup>5</sup> Ibid.

<sup>6</sup> Ibid page 211.

outcome is often transitioned over a long period of time (sometimes years) to allow for the changes to be implemented thoughtfully and at time in stages to minimise the impact on businesses.

With this in mind, we highlight that our products have been offered in the same way for 20 years and yet the key aspects of the Product Intervention Order, particularly around material restrictions on leverage, to our knowledge, have never been the subject of any proposed legislative or regulatory change prior to the Product Intervention Order announcement. The changes were also not staged and quite severe upfront, unfortunately leading to the consequence of indirectly prohibiting the distribution of certain classes of product to retail investors, even those that may understand the risks. This appears to be inconsistent with the desired outcome of the power when it was initially being discussed in the FSI Final Report.<sup>7</sup>

Our view is that formal law reform would have been a more transparent and fairer path for addressing any consumer concerns, with the potential for less reputational damage for industry participants, as it would have been a gradual consideration rather than being seen as an urgent action caused by the suggestion of extreme consumer detriment.

Another key aspect of the final decision for the Product Intervention Order was ASIC's concerns about some bad actors in the CFD and FX industry who had committed serious misconduct in breach of their Australian Financial Services Licenses. While the recent court actions do highlight egregious conduct by firms targeting Australians, they are isolated incidents and are not representative of the whole industry. The individuals and entities involved show a complete disregard for Australian laws and regulations and there is no reason to suggest those parties would not simply disregard the Product Intervention Order as well.

We also note, the successful outcomes in those cases demonstrate ASIC's other alternate path to a Product Intervention Order, to deal with poor conduct that was detrimental to clients via enforcement and court action.

*Recommendation: Limit the use of the Product Intervention Power to circumstances where ASIC has no other option or where formal law reform is clearly going to take too long*

ASIC's published Regulatory Guidance on how it can use the Product Intervention Power is very high level and flexible, enabling a broad interpretation for when it may be used.<sup>8</sup> While this assists ASIC in being able to use the Power in new circumstances that may not yet be contemplated, it does discourage businesses as there is a risk of a sudden material regulatory change that cannot be defined.

Ultimately the power for new policy and legislative decisions should continue to be a matter for Government. The Product Intervention Power should only be used where there are clear gaps in current legislative standards, and where other typical law reform paths or enforcement would take too long. This view is supported by the fact that the Power is designed to be short-term in nature, requiring ministerial approval to be made permanent.

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<sup>7</sup> Financial System Inquiry Final Report Recommendation page 212 - "Some international jurisdictions have prohibited the distribution of certain classes of product to retail consumers. For example, in the United Kingdom, non-mainstream investment products are prohibited from being distributed to retail consumers. Although such measures may reduce the risk of detriment, they take a broad approach and remove choice across a range of products for consumers who may understand the risk involved. For this reason, the Inquiry does not recommend them".

<sup>8</sup> ASIC Regulatory Guide 272 Product intervention power (RG 272).

This would also suggest that ASIC should not be able to use the Product Intervention Power to make changes to products that have been offered the same way for a long period of time as ASIC would have limited opportunity to claim that law reform is not a viable alternative (and that a 'power of last resort' is required) in these circumstances.

2. As part of its overall assessment of ASIC's performance against its mandate, the proposed Financial Regulator Assessment Board should assess the use of this new power

We note the Select Committee's mention of the establishment of a regulator performance role within the Department of Prime Minister and Cabinet, aimed at measuring, benchmarking and evaluating regulator performance. We are supportive of this decision and of the other statements made by the Select Committee around regulators being more mindful of competition issues.

We believe that clear and transparent checks and balances on the use of the Product Intervention Power will provide much needed certainty for FinTech firms looking to establish and grow their businesses in Australia.

*Recommendation: We believe it would be useful for the new role in the Department of Minister and Cabinet to regularly monitor and evaluate the use of the Product Intervention Power*

This is important as currently there is no avenue for independent review of the Product Intervention decisions made by ASIC, except via the courts which cannot question the merits of ASIC's decision making unless it is illegal. Given the broad nature of the current drafting of the legislation, this legal review avenue is unlikely to be successful except in extreme cases.

3. Firms with robust product design and distribution practices should not face additional regulatory costs

New design and distribution obligations under *Corporations Act Part 7.8A* were implemented at the same time the Product Intervention Power was announced ("**Design and Distribution Obligations**").<sup>9</sup>

The Design and Distribution Obligations require firms to consider who their target markets are, ensure the products they offer are suitable for those in the target markets, and to ensure that products are not distributed outside of those target markets. Compliance with these obligations would address issues such as vulnerable clients accessing products that are not suitable for them but also allow for clients who do understand the risks to continue to access the products they want.

Unfortunately, the CFD and FX industry was not given the opportunity to implement the Design and Distribution Obligations as a way of dealing with ASIC's concerns even though the reforms are scheduled to enact in October 2021, which is only 6 months after the Product Intervention Order enacts. This avenue would have been preferable to us as it would likely have had less reputational impact on our industry, as these obligations apply to the entire financial services industry, and would have enabled consumers who do understand the risks to have a broader product choice. Many of our clients are already looking for overseas alternatives that are able to offer less restrictive trading terms. It is also likely that other overseas clients who moved their business to Australia because of the flexible trading conditions that were open to them

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<sup>9</sup> *Treasury Laws Amendment (Design and Distribution Obligations and Product Intervention Powers) Act 2019.*

here, will move back to more traditional financial services countries such as UK or Europe now that Australia is offering identical restricted requirements.

*Recommendation: ASIC should only turn to Product Intervention where Design and Distribution Obligations have failed, except in extreme circumstances*

This recommendation is about ensuring Product Intervention is used only as a last resort.

### **In Conclusion**

We acknowledge that the Government is unable to take action about the Product Intervention Order that has materially impacted the CFD and FX industry until it is due for renewal, but we believe that it is important for the Select Committee to be provided with first-hand insight into how the Power can operate more effectively for both our industry in particular and for FinTech firms more generally.

Our recommendations are not new, in making these submissions we are asking that the Government consider aligning ASIC's current use of the Product Intervention Power with the considerations of the original Financial Systems Inquiry that first recommended it. We believe a key aspect of this is making sure that major policy and legislative reforms decisions remain in the hands of Government.

We believe that ASIC should remain a valued advisor to Government on law reform issues and a strong "corporate cop" ensuring compliance with current Australian law. The Product Intervention Power expands this role allowing ASIC to be an independent decision maker on new laws that it then can enforce, with limited to no real recourse for the businesses that are impacted. Even though the impact of an Order is a maximum of 18 months, it can still irreparably damage Australian businesses. In our view it is therefore critically important that the Power be available to ASIC in only very limited circumstances.

We hope this submission has provided some assistance to the Select Committee. We are happy to provide additional information if required.

Yours Sincerely,

Tamas Szabo  
**Group CEO**  
**Pepperstone**