

Senate Standing Committee on Economics

ANSWERS TO QUESTIONS ON NOTICE

Treasury Portfolio

Supplementary Budget Estimates

17 October – 18 October 2012

Question: **SBT 174-179**

Topic: **Potential crack-down on brokers selling over-the-counter derivatives who use client money as working capital for their firms**

Written: **Received from Committee – 26 October 2012**

Senator BUSHBY asked:

In the article ‘ASIC backs CFD crackdown’, Australian Financial Review, 16/7/2012, pg. 19, it stated that ASIC is supportive of a contracts-for-difference provider crackdown. To further this notion, ASIC warned the government over two years ago about the issues with the current laws, as they leave clients exposed when their financial brokers experience financial hardship.

In relation to the above, can ASIC please provide answers to the following:

- 174. What was the government’s response when ASIC raised their concerns over the current CFD laws two years ago?
- 175. How many individuals have fallen victim to these laws in the last two years?
- 176. What reforms are necessary to protect clients when their brokers experience financial difficulties?
- 177. How long would these reforms take to initialise?
- 178. Has there been any statistical analysis of how many investors utilise CFD as a result of prime-time advertising?

In relation to the above, can Treasury please provide answers to the following:

- 179. Has the department previously considered changing these laws.

Answer:

- 174. ASIC first wrote to Treasury in December 2008, setting out various risks to clients that arise by the operation of the client money provisions in Division 2 of Part 7.8 of the Corporations Act. In this letter, we also advised Treasury that we intended to prepare a Regulatory Guide concerning the client money provisions.

In July 2010 ASIC published Regulatory Guide 212 *Client money relating to dealing in OTC derivatives*.

On 30 August 2010, Treasury emailed ASIC for comment on a draft consultation paper that proposed legislative reforms to the client money provisions. ASIC provided comments to Treasury on the draft consultation paper by letter dated 23 September 2010.

Treasury and ASIC then corresponded on the draft consultation paper in October 2010 and from April 2011 until Treasury released its Discussion Paper *Handling and use of client money in relation to over-the-counter derivatives transactions* in November 2011. On 20 April 2012, ASIC made a confidential submission to Treasury’s Discussion Paper.

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Treasury continues to liaise with ASIC about the responses to the Discussion Paper.

175. ASIC would not normally describe clients affected by client money losses as victims of the client money provisions. However, there has been one recent, high profile AFS licensee insolvency case where clients have incurred significant delays in being able to access client money and may ultimately suffer a loss of client money. This was the case of MF Global Australia Limited and MF Global Securities Limited (collectively, MFGA).

MFGA was placed into voluntary administration on 1 November 2011, following the US parent entity filing for Chapter 11 bankruptcy. MFGA held 16,124 client accounts, of which 11,049 were active at the date administrators were appointed. We understand that about \$320million is owed by MF Global to clients, based on notifications on the website of the Administrator, Deloitte.

While it had retained client money in client trust accounts, MF Global also paid client money out of client trust accounts, as permitted under s981D of the Corporations Act. This money was paid to support hedging of client trades in CFDs and margin foreign exchange, as well as futures trades.

MF Global paid money to related parties overseas and financial counterparties such as Deutsche Bank and ASX Clear (via a UK affiliate who cleared its futures trades.) This has delayed the return of client money to clients. It is also possible that some clients will not receive all the money that they deposited with MF Global. However, the administrators have recovered a significant proportion of monies owed to clients and we understand they have also made some payments to clients.

Were all client monies retained in client trust accounts, it is possible that clients would have received their funds more promptly and would not have faced the same risk of loss.

While we are aware of other instances of breaches of client money provisions, including breaches uncovered in a recent industry compliance review, these breaches did not result in losses to clients.

176. This questions is seeking ASIC's position on policy advice. ASIC contributes policy advice to the Government and is not in a position to communicate this advice to the Committee.
177. This questions is seeking ASIC's position on policy advice. ASIC contributes policy advice to the Government and is not in a position to communicate this advice to the Committee.
178. ASIC does not have any statistics on the proportion of CFD investors who were induced to trade CFDs by prime-time advertising. Nor is ASIC aware of any publicly-available statistics on this subject. However, it is possible that private, industry-commissioned research may include information about how retail investors that trade CFDs found out about CFDs via advertising in different media.

ASIC sees regulation of advertising as important. ASIC released Regulatory Guide 234 *Advertising financial products and advice services: Good practice guidance* in February 2012. This guide contains good practice guidance to help AFS licensees comply with their legal obligations not to make false or misleading statements or engage in misleading or deceptive conduct.

Anecdotally, ASIC has observed CFD products being advertised in financial publications, online and via display advertising, such as in airports. CFD issuers also sometimes advertise on cable television and sometimes act as 'experts' during finance news broadcasts.

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179. Treasury has considered a range of options to reform the current laws regarding the use of client monies in relation to the trading of over-the-counter derivatives by retail investors.

As a result of this consideration, the Government released a discussion paper – ‘Handling and the use of client money in relation to over-the-counter derivative transactions’ - in November 2011. The paper considered a range of issues, including whether the current laws provide sufficient protection for investors.

Over 100 submissions were received in response to the discussion paper, including a submission from ASIC. A number of complex issues were raised in submissions and the claimed effects of any change to the laws around the use of client monies varied greatly between submissions.

Treasury is currently working closely with ASIC to further develop reform options which will ensure adequate investor protections while balancing industry compliance costs.