Could ASIC ban CFD trading in Australia? An expert's investigation

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Contracts for Difference have had a tumultuous run over the last 7 years, starting with the global financial crisis, as trading conditions became a lot more volatile.

A recent article published in the Financial Review by Patrick Durkin, highlighted that ASIC may be granted new powers by the government to put products like Contract for Difference (CFDs) under review. The question on the mind of brokers and traders alike is 'Could ASIC ban CFD trading here in Australia? '

CFDs could be banned in Australia

Mr Durkin noted 'Margin loans, contracts for difference and bank warrants could be curtailed or banned under far-reaching new powers to be granted to the corporate regulator by the government in response to the Financial System Inquiry.'

Given the leveraged nature of CFD trading, retail traders with little experience of money management, stop loss strategies and trading on leverage, have always been a potential black spot.

Access to huge amounts of financial leverage

Depending on your CFD broker, you may get access to 100 times leverage on your trading account. This means a $1,000 trading account could access a total position size up to $100,000 in value. As you can see, someone who lacks the experience or discipline is going to run into trouble pretty quickly.

Having spoken to ASIC Chairman Greg Medcraft in CFD Forum meetings and at industry events, it is clear Greg is not an advocate of retail traders getting access to highly leveraged, derivative products. Greg has often made it clear the CFD industry needs to self-regulate, and take matters under their own control.

Self Regulation

By self-regulation, he means the CFD and Forex industry here in Australia needs to work together on a set of principles and regulations that all CFD brokers can adhere to.

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As a result, the CFD Forum was formed (back in 2012) but was largely made up of UK based CFD brokers based here in Australia with the dedicated Direct Market Access (DMA) brokers, lobbying together to form a separate Forum. This really divided the industry and even got TV coverage on ABC's Four Corners program.

One could suggest the mere fact the CFD & FX brokers here in Australia cannot agree to work together, then ASIC may indeed need to step in and put their foot down. At the very least, this new power will likely serve as a warning to work together or we'll do the work for you…and you may not like the outcome.

ASIC has already created a new Derivative reporting requirement imposed on Over the Counter (OTC) vendors to ensure they are reporting all derivative transactions and positions in an open and transparent manner. This comes into effect in December 2015.

So what will this mean to the CFD industry here in Australia?

It appears ASIC has a mandate to target high risk products aimed at the retail market. Contracts for Difference provide access to a great deal of leverage and as mentioned, in the wrong hands, this can spell trouble.

As a result, if the industry cannot provide their own independent guidelines and measures to protect the retail market, then ASIC may not have a choice but to ban CFDs for those who do not qualify.

In industry forums a great deal of talk has happened around providing a series of questions to ensure new clients understand the risks and leveraged nature of the product.

Are you qualified to trade CFDs?

CFD & Forex brokers here in Australia should have a qualifying questionnaire asking specific questions around the risks involved when trading CFDs, for new clients. It would be fair to say the majority of CFD brokers already have a qualifying questionnaire in place.

Whilst this doesn't stop traders losing more than expected when trading on leverage, it at least spells out the dangers and risks of trading on a leveraged product. This allows potential CFD traders to understand if CFDs are suitable for them or not.

As Mr Kell suggests in the AFR interview, ‘It is really about making sure that the people to whom products are directed are suitable to receive those products, not at an individual level but at a group level.”

To be honest, that is quite fair.

We’ll have to watch this space and see what developments occur and how ASIC flexes its regulatory muscles going forward.

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