

November 2, 2009

Contracts for Difference: Gambling for Retail Investors

FAIR Canada applauds the OSC on the concerns for investor protection expressed in the Staff Notice about [Contracts for Difference \(CFDs\)](#) and foreign exchange (forex) contracts. Enforcing plain language risk disclosure, minimum margin requirements, “know your client” and suitability rules are necessary protections that should also be extended to other complex and high fee products.



However, FAIR Canada is concerned that the OSC approved these products (and last year’s SPACs/“blind pool” IPOs) without public consultation or consulting retail investors and other affected parties. FAIR Canada strongly believes that the introduction of new speculative products targeted to retail investors (like CFDs and last year’s SPACs) require full public consultation and a public examination of their costs and benefits.

OSC Staff Notice and CMC Markets Exemption

Last week, the OSC issued a [Staff Notice](#) providing guidance on regulatory requirements for offerings of Contracts for Difference (CFDs), forex contracts and other similar products. The issuance of the Staff Notice follows an [announcement](#) last week by CMC Markets Canada (CMC Markets) that the OSC has approved the offering of CFDs to retail investors. This follows an earlier decision of the AMF in Quebec to permit the sale of CFDs to retail investors.

The Staff Notice states that staff are of the view (correctly, we believe) that CFDs are subject to regulation under Ontario securities law. The Notice also identifies significant investor protection concerns raised by the offering of CFDs to retail investors. The OSC’s response to these concerns is to require that firms that offer CFDs be registered under securities legislation and be members of IIROC. Requiring firms offering CFDs to be IIROC members goes a long way towards addressing investor protection concerns as IIROC imposes rules for minimum margin, “know your client” (KYC) and “suitability” obligations. IIROC also expects its members offering CFDs to:

1. Provide retail investors with clear risk disclosure documents;
2. Assess the investment knowledge and experience of the client; and
3. Set cumulative loss limits for each client account.

The OSC will exempt firms issuing CFDs from prospectus requirements if they follow the requirements to be IIROC members and provide a plain language risk disclosure statement to retail clients.

The OSC response to the serious investor protection concerns raised by CFDs is an appropriate regulatory response. In fact, we recommend that the OSC consider extending the model to other high risk derivative products, such as leveraged, inverse and commodity ETFs.

The model for high risk derivative products would include:

1. **Mandating IIROC membership, which brings with it additional requirements, as well as oversight by IIROC;**
2. **Plain language risk disclosure statements;**
3. **Assessment of the investment knowledge and trading experience of the investor; and**
4. **Suitability obligation or client-signed waiver of “suitability”.**

While the OSC response to CFD’s has a number of positive aspects, it does raise some concerns about transparency and process. It also raises questions of investor protection and the public interest.

Transparency and Process Demand Public Consultation

We understand that the OSC has been considering the application of CMC Markets and the issue of CFDs for three years. The Staff Notice makes it clear that the guidance is intended to be considered generally in the context of offerings of CFDs, forex contracts and similar OTC derivatives to investors in Ontario. Why did the OSC not publish its staff policy decision for public consultation? The issue has been under consideration for several years, so time was not a critical issue. There is really no substantive difference between publication of the Staff Notice together with the CMC Markets exemption order, and the issuance of a policy statement. Had the OSC issued a “policy”, it would have been required to publish the proposed policy for public comment.

In making the decision on regulation of CFDs, forex and similar products, the OSC had the benefit of ongoing correspondence with CMC Markets. No doubt the OSC privately consulted stakeholders and clearly involved IIROC in the process.

Retail investors and the general public were not consulted. Clearly, retail investors and the public have an interest in the introduction of highly leveraged, highly speculative products for sale to retail investors.

CFDs are really a form of gambling. Margin requirements are generally set between 1% and 10%. An investor can lose much more than 100% of his or her investment. Even with the application of IIROC’s stricter margin requirements, a retail investor can potentially lose much

more than 100% of the initial investment. Retail investors may be better off going to Casino Rama than trading CFDs. At Casino Rama, they can only lose 100%.

The OSC appears to have taken the position that it will allow virtually any product to be sold to retail investors, without a public consultation about whether introducing the product is consistent with its investor protection mandate and is in the public interest. Last year, the OSC approved the introduction of SPACs or “blank cheque” IPOs (which had been prohibited by the OSC for decades), again without public consultation.

If the capital markets are being expanded to including gaming and if the OSC is expanding its remit to be a securities and gaming regulator, perhaps the public should be consulted. We urge the OSC to correct the lack of transparency and the process concerns by conducting a public consultation on CFDs. The OSC might also consider a public consultation on “blank cheque” IPOs where it might articulate why it reversed the decades old OSC policy not to permit “blank cheque” IPOs.

Click here to read the related [Globe and Mail article](#) from October 25, 2009.