



**ASIC**  
Australian Securities &  
Investments Commission

## Explanatory Statement

### *ASIC Corporations (Product Intervention Order–Contracts for Difference) Instrument 2020/986*

This is the Explanatory Statement for ASIC Corporations (Product Intervention Order–Contracts for Difference) Instrument 2020/986 (the *instrument*).

The Explanatory Statement is approved by the Australian Securities and Investments Commission (*ASIC*).

### Summary

1. The instrument is a product intervention order made under subsection 1023D(3) of the *Corporations Act 2001* (the *Act*). The instrument imposes certain conditions on specified dealing in over-the-counter (OTC) contracts for difference (CFDs) in relation to retail clients, prohibits giving or offering specified benefits to retail clients or prospective retail clients in specified circumstances and requires CFD issuers to take reasonable steps to notify its retail clients of the terms of the instrument.

### Legislative authority

2. The instrument is made under subsection 1023D(3) of the *Corporations Act 2001*.
3. Under subsection 1023D(3) of the Act, if ASIC is satisfied that a class of financial product:
  - (a) is, or is likely to be, available for acquisition by issue, or for regulated sale, to persons as retail clients (whether or not it also is, or is likely to be, available for acquisition by persons as wholesale clients); and
  - (b) has resulted in, or will or is likely to result in, significant detriment to retail clients;

ASIC may, by legislative instrument, order that a person must not engage in specified conduct in relation to the class of financial products, either entirely or except in accordance with conditions specified in the order.

4. A description of the significant detriment is set out in Attachment A, the Product Intervention Order Notice.
5. The instrument is a disallowable legislative instrument.

## **Purpose of the instrument**

6. The purpose of the instrument is to reduce the risk of significant detriment to retail clients resulting from CFDs:
  - (a) The leverage ratio limits set out in subsection 7(2) of the instrument are expected to reduce the size and speed of retail clients' CFD losses by reducing CFD exposure and the sensitivity of CFDs to market volatility;
  - (b) Margin close out protection set out in subsection 7(3) of the instrument is expected to standardise a common risk management feature that acts as a circuit breaker to close out one or more of the open CFDs connected to a retail client's CFD trading account in circumstances where the retail client has lost a substantial proportion of the funds in that trading account;
  - (c) Negative balance protection set out in subsection 7(5) of the instrument is expected to standardise a risk management feature offered by some CFD providers that protects retail clients by limiting their losses on CFD positions to the funds in their CFD trading account; and
  - (d) Section 6 of the instrument prohibits offering or giving specified inducements to retail clients and prospective retail clients that encourage higher trading volumes and can distract them from the risks of trading CFDs, while not barring discounts of fees and costs that are offered to all retail clients and prospective retail clients.

## **Operation of the instrument**

### ***Name***

7. Section 1 of the instrument provides that the instrument is the *ASIC Corporations (Product Intervention Order—Contracts for Difference) Instrument 2020/986*.

### ***Commencement***

8. Section 2 of the instrument provides that the instrument commences on the later of 23 November 2020 and the day after it is registered on the Federal Register of Legislation.

### ***Authority***

9. Section 3 of the instrument provides that the instrument is made under subsection 1023D(3) of the *Corporations Act 2001*.

### ***Interpretation***

10. Unless a contrary intention appears in the instrument, a term that is defined in section 761A of the Act has the same meaning in the instrument: see sections 761A and 761H of the Act.
11. Subsection (4)(1) of the instrument provides that, in the instrument:

*Act* means the *Corporations Act 2001*.

**CFD** means a derivative that:

- (a) is a contract for difference; and
- (b) is provided by a person (**CFD issuer**) who carries on a business of issuing contracts for difference to other persons (**holders**).

**CFD issuer**: see the definition of **CFD**.

**CFD trading account** means a trading account that a holder has with a CFD issuer, through which the holder can place orders to acquire and dispose of CFDs.

**client money account** means, in relation to CFD issuer, an account maintained by the CFD issuer for the purposes of section 981B of the Act.

**contract for difference** means a derivative to which the following apply:

- (a) the value of the derivative, or the amount of consideration to be provided under the derivative, is ultimately determined, derived from or varies by reference to (wholly or in part) the change, between the acquisition and termination of the derivative, in the amount or value of an underlying specified under the terms of the derivative;
- (b) the derivative is not able to be traded on a licensed market;
- (c) the derivative:
  - (i) does not terminate on a fixed date; or
  - (ii) if the derivative terminates on a fixed date—it is a derivative of a kind that are typically terminated before the fixed date;
- (d) the holder has the right to terminate the derivative;
- (e) on termination, the obligations of the parties are settled in cash or by set-off between the parties.

**cryptoasset** includes cryptocurrency.

**exchange rate for a major currency pair** means an exchange rate for a pair of currencies that consists of any two of the following:

- (a) Australian dollar;
- (b) British pound;
- (c) Canadian dollar;
- (d) euro;
- (e) Japanese yen;
- (f) Swiss franc;

(g) US dollar.

**exchange rate for a minor currency pair** means an exchange rate for a pair of currencies that is not an exchange rate for a major currency pair.

**holder**: see the definition of **CFD**.

**initial margin** means the margin which a CFD issuer requires to be provided by a holder in relation to the issue, or proposed issue, of a CFD to the holder.

**major stock market index** means any of the following stock market indices:

- (a) CAC 40;
- (b) DAX;
- (c) Dow Jones Industrial Average;
- (d) EURO STOXX 50 Index;
- (e) FTSE 100;
- (f) NASDAQ-100 Index;
- (g) NASDAQ Composite Index;
- (h) Nikkei Stock Average;
- (i) S&P 500;
- (j) S&P/ASX 200.

**minor stock market index** means a stock market index that is not a major stock market index.

**net equity**, in relation to a CFD trading account of a retail client, means the sum of:

- (a) derivative retail client money held both:
  - (i) in a client money account for the benefit of the retail client; and
  - (ii) in relation to the CFD trading account; and
- (b) any other money:
  - (i) held both:
    - (A) in the client money account for the benefit of the retail client; and
    - (B) in relation to the CFD trading account; and
  - (ii) that was paid into the client money account by the CFD issuer in relation to a dealing in a CFD by the retail client; and

- (c) the value of derivative retail client property held for the benefit of the retail client and in relation to the CFD trading account; and
- (d) to the extent not referred to in (a) or (b)—the unrealised profits (if any) of the retail client less the unrealised losses (if any) of the retail client for all of the retail client’s open CFDs that are connected to the CFD trading account.

**open** in relation to a CFD means a CFD that has not been terminated.

**terminate**, in relation to a derivative, includes the derivative being closed out.

**underlying**, in relation to a derivative, means any thing (of any nature whatsoever and whether or not deliverable) other than the derivative, including, for example, one or more of the following:

- (a) an asset;
- (b) a rate (including an interest rate or exchange rate);
- (c) an index;
- (d) a commodity.

12. The definition of **contract for difference** in subsection (4)(1) of the instrument reflects the definition of that term in sub-regulation 7.1.22AA(3) of the Corporations Regulations 2001. After paragraph (a) of the definition of **contract for difference** in the instrument, are two notes that clarify that:

(a) by way of example, a derivative under which, at termination, the amount of consideration payable depends (wholly or in part) on the change in the level of a stock market index over the term of the derivative; and

(b) there may be other factors that affect the value of the derivative. For example, fees and costs.

13. After paragraph (c)(ii) of the definition of **contract for difference** in the instrument, there are two notes. The first note clarifies that, by way of example, the derivative may have a fixed termination date if the underlying has a fixed termination date. The second note further clarifies this to mean that options, futures, swaps and forward rate agreements will generally not be contracts for difference.

14. After paragraph (d) of the definition of **contract for difference** in the instrument, a note is included clarifying that the terms of the derivative may provide for its termination in other circumstances, such as on the occurrence of an event of default or on the issuer (other than the holder) exercising a right to terminate the derivative.

15. After the definition of **contract for difference** in the instrument, a note is included clarifying that ‘derivative’ is defined in section 761D of the Corporations Act.

16. After paragraph (d) of the definition of *net equity* in the instrument, a note is included clarifying that the amount referred to in that paragraph and the amount of net equity may be negative.
17. Subsection 4(2) of the instrument provides that, for the purposes of the instrument, a reference to offering to issue a CFD includes a reference to inviting an application for the issue of the CFD.

#### *Conditions on dealing in CFDs in relation to retail clients*

18. Subsection 5(1) of the instrument provides that a CFD issuer must not issue a CFD to a retail client except in accordance with the conditions specified in subsections 7(2) to (5) of the instrument.
19. Subsection 5(2) of the instrument provides that a person who carries on a business of arranging for the issue of CFDs must not arrange for the issue of a CFD by a CFD issuer to a retail client except in accordance with the conditions specified in subsections 7(2) to (5) of the instrument.
20. Subsection 5(3) of the instrument provides that a person who carries on a business of applying for, or acquiring, CFDs as an agent must not apply for, or acquire, a CFD from a CFD issuer on behalf of a retail client except in accordance with the conditions specified in subsections 7(2) to (5) of the instrument.
21. Subsection 5(4) of the instrument provides that a person who carries on a business of arranging for persons to apply for, or acquire, CFDs must not arrange for a retail client to apply for, or acquire, a CFD from a CFD issuer except in accordance with the conditions specified in subsections 7(2) to (5) of the instrument.

#### *Application of conditional prohibitions*

22. Subsection 5(5) of the instrument provides that subsections 5(1) to 5(4) of the instrument apply on and from 29 March 2021.
23. Subsection 5(6) of the instrument provides that subsection 5(1) of the instrument applies only to one or both of the following:
  - (a) the CFD issuer is:
    - (i) a body corporate incorporated or carrying on business in Australia; or
    - (ii) an Australian citizen; or
    - (iii) ordinarily resident in Australia;
  - (b) the issue of the CFD occurs in this jurisdiction, or an offer to issue the CFD, or to apply for the issue of the CFD, is received in this jurisdiction.

24. Subsection 5(7) of the instrument provides that subsection 5(2) of the instrument applies only if one or both of the following apply:

- (a) the person who carries on a business of arranging for the issue of CFDs is:
  - (i) a body corporate incorporated or carrying on business in Australia; or
  - (ii) an Australian citizen; or
  - (iii) ordinarily resident in Australia;
- (b) the arranging for the issue of the CFD takes place in circumstances where:
  - (i) the issue of the CFD occurs in this jurisdiction; or
  - (ii) an offer to issue the CFD or to apply for the issue of the CFD is received in this jurisdiction.

25. Subsection 5(8) of the instrument provides that subsection 5(3) of the instrument applies only if one or both of the following apply:

- (a) the person who carries on a business of applying for, or acquiring, CFDs as an agent is:
  - (i) a body corporate incorporated or carrying on business in Australia; or
  - (ii) an Australian citizen; or
  - (iii) ordinarily resident in Australia;
- (b) the applying for, or acquiring, the CFD on behalf of the retail client takes place in circumstances where:
  - (i) the issue of the CFD occurs in this jurisdiction; or
  - (ii) an offer to issue the CFD or to apply for the issue of the CFD is received in this jurisdiction.

26. Subsection 5(9) of the instrument provides that subsection 5(4) of the instrument applies only if one or both of the following apply:

- (a) the person who carries on a business of arranging for persons to apply for, or acquire, CFDs is:
  - (i) a body corporate incorporated or carrying on business in Australia; or
  - (ii) an Australian citizen; or
  - (iii) ordinarily resident in Australia;

- (b) the arranging for the retail client to apply for or acquire the CFD takes place in circumstances where:
  - (i) the issue of the CFD occurs in this jurisdiction; or
  - (ii) an offer to issue the CFD or to apply for the issue of the CFD is received in this jurisdiction.

27. After subsection 5(9)(b)(ii) of the instrument, there are two notes which clarify that:

- (a) the application of the orders in section 5 of the instrument is subject to the limitation in section 1023C of the Act; and
- (b) subject to the Court making an order staying or otherwise affecting the operation of the orders in section 5 of the instrument, the orders will remain in force for 18 months from the day the instrument commences, citing subsection 1023G(2) of the Act.

### ***Prohibition on providing inducements to retail clients in relation to CFDs***

28. Subsection 6(1) of the instrument provides that a person must not, in the course of carrying on a business, give or offer a prohibited benefit to a retail client or prospective retail client of a CFD issuer in circumstances where the issue of a CFD to the client by the CFD issuer would be covered by the conditional prohibition in subsection 5(1) of the instrument (assuming that the issue occurred at a time when the conditional prohibition was in force under subsection 5(5) of the instrument).

29. Subsection 6(2) of the instrument defines a ***prohibited benefit*** in relation to a retail client or prospective retail client of a CFD issuer to mean, in section 6 of the instrument, a gift, discount, rebate, trading credit or reward that is given or offered as an inducement to the retail client or prospective retail client to do any of the following:

- (a) open a CFD trading account with the CFD issuer;
- (b) pay the CFD issuer money that is derivative retail client money in relation to a CFD;
- (c) give the CFD issuer property that is derivative retail client property in relation to a CFD;
- (d) acquire a CFD from the CFD issuer.

30. Subsection 6(3) of the instrument specifies that, despite subsection 6(2) of the instrument, none of the following is a prohibited benefit:

- (a) the provision of, or access to, an information service or an educational or research tool;
- (b) a discount in costs or fees (including a volume-based discount) that is offered to all retail clients and prospective retail clients;

- (c) a gift, discount, rebate, trading credit or reward that is given in relation to any of the matters referred to in paragraphs 6(2)(a) to (d) of the instrument to the extent that the matter was done by the retail client before 29 March 2021.

#### *Application of prohibition*

31. Subsection 6(4) of the instrument specifies that the application of the prohibition applies on and from 29 March 2021.

32. After subsection 6(4) of the instrument, two notes clarify that:

- (a) the application of the order in section 6 is subject to the limitations in section 1023C of the Act; and
- (b) subject to the Court making an order staying or otherwise affecting the operation of the order in section 6, the order will remain in force for 18 months from the day the instrument commences, citing subsection 1023G(2) of the Act.

#### ***Conditions applying to dealings in CFDs in relation to retail clients***

33. Subsection 7(1) of the instrument provides that the conditions in subsections 7(2) to (5) of the instrument are specified for the purposes of subsections 5(1) to (4) of the instrument.

#### *Leverage and margin restrictions*

34. Subsection 7(2) of the instrument provides that the terms of the CFD must require the retail client to provide an initial margin of at least:

- (a) if the underlying for the CFD is an exchange rate for a major currency pair—3.33% of the notional value of the CFD at the time of issue (equivalent to 30:1 leverage);
- (b) if the underlying for the CFD is a major stock market index, an exchange rate for a minor currency pair or gold—5% of the notional value of the CFD at the time of issue (equivalent to 20:1 leverage);
- (c) if the underlying for the CFD is a minor stock market index or a commodity other than gold—10% of the notional value of the CFD at the time of issue (equivalent to 10:1 leverage); and
- (d) if the underlying for the CFDs is a cryptoasset—50% of the notional value of the CFD at the time of issue (equivalent to 2:1 leverage); and
- (e) if the underlying for the CFD is not referred to in subsection 7(2) (a) to (d) of the instrument—20% of the notional value of the CFD at the time of issue (equivalent to 5:1 leverage).

#### *Margin close out protection*

35. Subsection 7(3) of the instrument provides that the terms of the CFD must provide that if at any time the net equity of the retail client's CFD trading account is less than the

aggregate close out protection amount for the retail client's open CFDs at that time that are connected to that account, the CFD issuer must, as soon as market conditions allow, terminate one or more of the following:

- (a) the retail client's open CFDs that are connected to the retail client's CFD trading account and that were issued on or after 29 March 2021;
- (b) any other of the retail client's open CFDs that are connected to the retail client's CFD trading account and that are specified in the terms of the CFD for the purposes of subsection 7(3) of the instrument;

until the time (*later time*) at which the first of the following occurs:

- (c) the net equity of the retail client's CFD trading account being equal to or greater than the aggregate close out protection amount for the retail client's remaining open CFDs at the later time that are connected to that account;
- (d) all the following being terminated:
  - (i) the retail client's open CFDs that are connected to the retail client's CFD trading account and that were issued on or after 29 March 2021;
  - (ii) any other of the retail client's open CFDs that are connected to the retail client's CFD trading account and that are specified in the terms of the CFD for the purposes of subsection 7(3) of the instrument.

36. After subsection 7(3)(d)(ii) of the instrument, there are two notes that clarify that:

- (a) the CFD issuer must do all things necessary to ensure that it acts efficiently, honestly and fairly in terminating open CFDs, citing paragraph s 912A(1)(a) of the Act; and
- (b) before specifying, in the terms of the CFD for the purposes of subsection 7(3) of the instrument, a CFD (*other CFD*) that was issued before 29 March 2021, the CFD issuer will need to ensure that specifying the other CFD (meaning that the other CFD may be terminated in the circumstances contemplated by subsection 7(3) of the instrument) is consistent with the terms of the other CFD.

37. Subsection 7(4) of the instrument provides that, in subsection 7(3) of the instrument, **aggregate close out protection amount** means, in relation to open CFDs of a retail client at a time, an amount that is one of the following:

- (a) in any case—at least 50% of the aggregate initial margin required under paragraphs 7(2)(a) to (e) of the instrument for those open CFDs;
- (b) if the margin (*current margin*) which the CFD issuer requires to be provided by the holder in relation to the holding of each open CFD at that time is equal to or greater than the initial margin that would have been required under paragraphs 7(2)(a) to (e) of the instrument if the open CFD had been issued at the time the current margin was determined—at least 50% of the aggregate current margin for those open CFDs.

### *Negative balance protection*

38. Subsection 7(5) of the instrument provides that the terms of the CFD must provide that if the retail client incurs a liability under the CFD, the recourse of the CFD issuer is limited to the following:

- (a) derivative retail client money held both:
  - (i) in a client money account for the benefit of the retail client; and
  - (ii) in relation to the retail client's CFD trading account;
- (b) any other money:
  - (i) held both:
    - (A) in the client money account for the benefit of the retail client; and
    - (B) in relation to the CFD trading account; and
  - (ii) that was paid into the client money account by the CFD issuer in relation to a dealing in a CFD by the retail client;
- (c) derivative retail client property held for the benefit of the retail client and in relation to the CFD trading account.

### *CFD issuers to notify retail clients of the product intervention order*

39. Section 8 of the instrument provides that a CFD issuer that has issued a CFD to a retail client in the period of 12 months before commencement of the instrument in circumstances which would be covered by the conditional prohibition in subsection 5(1) of the instrument (assuming that the issue occurred at a time when the conditional prohibition was in force under subsection 5(5) of the instrument) must take reasonable steps to notify each such retail client of the terms of the instrument as soon as practicable and in any case within 10 business days after commencement of the instrument.

### *Duration of the product intervention order*

40. Subsection 1023G(2) of the Act provides that a product intervention order remains in force for 18 months or any shorter period specified by the regulations or any shorter period specified in the order. No relevant period has been specified in the regulations.

41. The order in the instrument will remain in force for 18 months. The period of 18 months will allow ASIC sufficient time to assess the effectiveness of the instrument. It is also appropriate that the instrument be in force for 18 months in the context of the investment and changes to arrangements that CFD issuers will be making in order to comply with the instrument.

### **Prescribing matters by reference to other instruments**

42. The instrument makes references to certain financial market indices (referred to as *major stock market index*). However, the instrument does not apply, adopt or incorporate matter

contained in those indices, within the meaning of section 14 of the *Legislation Act 2003*. Section 14 of that Act is not engaged because the content of those indices does not affect the operation of the instrument.

43. The instrument refers to the following major stock market indexes:

- (a) CAC 40;
- (b) DAX;
- (c) Dow Jones Industrial Average;
- (d) EURO STOXX 50 Index;
- (e) FTSE 100;
- (f) NASDAQ-100 Index;
- (g) NASDAQ Composite Index;
- (h) Nikkei Stock Average;
- (i) S&P 500;
- (j) S&P/ASX 200.

44. The reference to the major stock market indexes occurs in the context of specifying the initial margin that the CFD issuer must require of a retail client if the underlying for the CFD is one of the listed major stock market indexes. The instrument is not applying, adopting or incorporating these major stock market indexes for the purposes of section 14 of the *Legislation Act 2003* either on a fixed or ambulatory basis, because the reference to the major stock market indexes does not affect the operation of the instrument but is only a reference point in determining an appropriate margin amount for the underlying major stock market index of the CFD.

## **Consultation**

45. On 22 August 2019, ASIC published Consultation Paper 322 *Product intervention: OTC binary options and CFDs* (CP 322), calling for feedback by 1 October 2019. CP 322 included, inter alia, an outline of the significant detriment to retail clients that ASIC considered has resulted from, or will or is likely to result from, CFDs and attached a proposed product intervention order (*CFD Proposal*).

46. CP 322 explained that the CFD Proposal, if made, would impose conditions on the issue and distribution of CFDs to retail clients. In summary, the conditions concerned:

- (a) leverage ratio limits (*CP 322 Condition 1*);
- (b) a standardised approach to automatic margin close-out of CFD positions (*CP 322 Condition 2*);
- (c) protection against negative balances (*CP 322 Condition 3*);

- (d) prohibition of certain inducements in relation to CFDs (*CP 322 Condition 4*);
- (e) prescribed risk warnings (*CP 322 Condition 5*);
- (f) real-time disclosure of total CFD position size (*CP 322 Condition 6*);
- (g) real-time disclosure of overnight funding costs (*CP 322 Condition 7*);
- (h) disclosure of a CFD pricing methodology and CFD execution policy (*CP 322 Condition 8*).

47. ASIC received over 400 submissions relating to the CFD Proposal in CP 322, including submissions from CFD providers, industry bodies, consumer groups, CFD consumers and members of the public. Additionally, ASIC met with a number of consumer groups and CFD issuers to discuss their submissions and to request cost estimates from CFD issuers.
48. The submissions to CP 322 were taken into account in making the instrument. The submissions are publicly available on ASIC's website, excluding confidential submissions.

***Summary of differences between the CFD Proposal and the terms of the instrument***

49. In summary, the terms of the instrument differ from the CFD Proposal in the following material respects:
- (a) The leverage ratio limits set out in subsection 7(2) of the instrument provide that the terms of the CFD must require the retail client to provide initial margin of at least:
    - (i) if the underlying for the CFD is an exchange rate for a major currency pair—3.33% of the notional value of the CFD at the time of issue (equivalent to 30:1 leverage, compared with 5% initial margin (20:1 leverage) for a CFD over any exchange rate for a currency pair in CP 322 Condition 1);
    - (ii) if the underlying for the CFD is a major stock market index—5% of the notional value of the CFD at the time of issue (equivalent to 20:1 leverage, compared with 6.67% initial margin (15:1 leverage) for a CFD over any stock market index in CP 322 Condition 1);
    - (iii) if the underlying for the CFD is a minor stock market index—10% of the notional value of the CFD at the time of issue (equivalent to 10:1 leverage, compared with 6.67% initial margin (15:1 leverage) for a CFD over any stock market index in CP 322 Condition 1); and
  - (b) Margin close out protection in subsection 7(3) of the instrument provides for an additional method of calculating the 'aggregate close-out protection amount', with reference to the total margin required for all of the open CFDs for a trading account;

- (c) Clarification of the prohibition of certain ‘prohibited benefits’ in section 6 of the instrument to expressly prohibit the giving or offering of discounts and rebates to a retail client or prospective retail client in specified circumstances and expressly carve-out discounts of fees and costs that are offered to all retail clients and prospective retail clients;
- (d) The instrument does not incorporate the proposals in CP Conditions 5-8;
- (e) The leverage ratio limits, negative balance protection measure and prohibition of certain prohibited benefits apply on and from 29 March 2021, compared with 20 business days after the day the instrument is registered on the Federal Register of Legislation in the proposal.

### ***Transitional period***

50. CFD issuers will need to implement arrangements to comply with the conditions imposed by the instrument. A balance is required between the need to commence these reforms speedily to avoid significant detriment to clients and the requirement for CFD issuers to adjust these systems.
51. The instrument will commence on 23 November 2020. CFD issuers will have until 29 March 2021 to adjust their systems and practices prior to the application of all conditions in the instrument. This provides CFD issuers with a total transition period of approximately 5 months. Amid public health orders and heightened market volatility during the COVID-19 pandemic, this sets an appropriate balance between the objective of reducing consumer harm and the requirement for an orderly transition period for CFD issuers (including allowance for the Christmas and New Year period).
52. The transition period will also allow time for retail clients to be notified of the effect of the instrument (see section 8 of the instrument) and consider the likely effect of the instrument on their CFD trading strategies before the policy measures take effect.

### ***Estimate of regulatory compliance burden***

53. ASIC has certified that it conducted a process and analysis equivalent to a Regulatory Impact Statement (OBPR ID: 26078). The following table sets out ASIC’s estimate of the regulatory compliance burden of this instrument using the Australian Government’s Regulatory Burden Measurement framework.

#### **Estimate of average annual regulatory costs**

<b>Change in costs (\$ million)</b>	<b>Business</b>	<b>Community organisations</b>	<b>Individuals</b>	<b>Total change in costs</b>
Total, by sector	\$22.4	\$0	\$0	\$22.4

### **Statement of Compatibility with Human Rights**

54. The Explanatory Statement for a disallowable legislative instrument must contain a Statement of Compatibility with Human Rights under subsection 9(1) of the *Human Rights (Parliamentary Scrutiny) Act 2011*. A Statement of Compatibility with Human Rights is set out in Attachment B.

## PRODUCT INTERVENTION ORDER NOTICE

### *ASIC Corporations (Product Intervention Order—Contracts for Difference) Instrument 2020/986*

#### Introduction

1. The Australian Securities and Investments Commission (*ASIC*) publishes this notice under subsection 1023L(3) of the *Corporations Act 2001* (the *Act*).
2. Subsection 1023L(3) of the Act requires ASIC to publish on its website, with each product intervention order made by ASIC under subsection 1023D(1) or (3) of the Act, a notice that:
  - (a) describes the significant detriment to retail clients that has resulted from, or will or is likely to result from, the financial product or class of financial products to which the order relates, and sets out why the order is an appropriate way of reducing the detriment; and
  - (b) describes the consultation that ASIC undertook in relation to the order; and
  - (c) if the order comes into force after it is published—specifies the day it comes into force.
3. This notice relates to *ASIC Corporations (Product Intervention Order—Contracts for Difference) Instrument 2020/986* (the *order*), which is a product intervention order made by ASIC by legislative instrument under subsection 1023D(3) of the Act. The order relates to contracts for difference (*CFDs*).
4. The order, together with notification requirements imposed by section 8 of the order under section 1023N of the Act, commences on the later of 23 November 2020 and the day after the order is registered on the Federal Register of Legislation. However, the conditional prohibitions relating to CFDs that are contained in section 5 of the order and the prohibition of giving or offering a prohibited benefit to a retail client or prospective retail client in specified circumstances contained in section 6 of the order apply on and from 29 March 2021.

#### CFDs are a class of financial product

5. The order is made in respect of CFDs. A ‘contract for difference’ is defined in the order as a derivative to which the following apply:
  - (a) the value of the derivative, or the amount of consideration to be provided under the derivative, is ultimately determined, derived from or varies by reference to (wholly or in part) the change, between the acquisition and termination of the derivative, in the amount or value of an underlying specified under the terms of the derivative;

Note 1: For example, a derivative under which, at termination, the amount of consideration payable depends (wholly or in part) on the change in the level of a stock market index over the term of the derivative.

Note 2: There may be other factors that affect the value of the derivative. For example, fees and costs.
  - (b) the derivative is not able to be traded on a licensed market;
  - (c) the derivative:
    - (i) does not terminate on a fixed date; or

- (ii) if the derivative terminates on a fixed date—it is a derivative of a kind that are typically terminated before the fixed date;

Note 1: For example, the derivative may have a fixed termination date if the underlying has a fixed termination date.

Note 2: This means that options, futures, swaps and forward rate agreements will generally not be contracts for difference.

- (d) the holder has the right to terminate the derivative;

Note: The terms of the derivative may provide for its termination in other circumstances. For example, on the occurrence of an event of default or on the issuer (other than the holder) exercising a right to terminate the derivative.

- (e) on termination, the obligations of the parties are settled in cash or by set-off between the parties.

6. The order also contains other definitions, such as ‘terminate’, which is an expression used in the definition of contract for difference. The definition of contract for difference in the order replicates the definition in subregulation 7.1.22AA(3) of the *Corporations Regulations 2001*.
7. CFDs are a class of financial product, as defined in section 1023B of the Act. As defined in the order, CFDs are derivatives. ‘Derivative’ is defined in section 761D of the Act. A derivative is a financial product (section 762A and paragraph 764A(1)(c) of the Act), unless it is specifically excluded by section 765A of the Act or by paragraphs (a) or (b) of the definition of financial product in section 1023B of the Act. CFDs are not specifically excluded from the definition of financial product by section 765A of the Act or by paragraphs (a) or (b) of the definition of financial product in section 1023B of the Act.

### **CFDs are available for acquisition by issue to retail clients**

8. At the time of making the order, CFDs are available for acquisition by issue to retail clients by Australian financial services licensees who are authorised to deal and make a market in derivatives to retail clients.

### **Significant detriment to retail clients**

9. This notice now describes the significant detriment to retail clients.
10. Subsection 1023E(1) of the Act requires that ASIC must take into account the following factors in considering whether a financial product has resulted in, or will or is likely to result in, significant detriment to retail clients:
  - (a) the nature and extent of the detriment;
  - (b) without limiting paragraph (a), the actual or potential financial loss to retail clients resulting from the product;
  - (c) the impact that the detriment has had, will have or is likely to have on retail clients; and
  - (d) any other matter prescribed by the regulations.<sup>1</sup>

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<sup>1</sup> As at the date of this notice, no matters are prescribed by the regulations.

11. The significant detriment to retail clients is conveniently described by reference to the matters referred to in paragraphs 1023E(1)(a)–(c) of the Act.

*Nature and extent of the detriment, including actual financial loss to retail clients*

12. The nature of the detriment to retail clients resulting from CFDs is primarily in the form of financial losses. Information available to ASIC indicates that CFDs have resulted in significant financial losses to retail clients.
13. The extent of the detriment to retail clients that has resulted from CFDs is evidenced by the proportion of retail clients' trading accounts that lost money trading CFDs and the quantum of financial losses to retail clients.
14. In 2017, ASIC conducted a review (**2017 review**) of the size and nature of the Australian market for binary options and CFDs and published [Report 579](#) *Improving practices in the retail OTC derivatives sector*. CFD issuers reported in ASIC's 2017 review that approximately 97% of their clients were retail clients and that:
  - (a) 63% of clients lost money trading 'margin FX' (a CFD with a currency pair as the underlying asset) over a 12-month period; and
  - (b) 72% of clients lost money trading other CFDs over a 12-month period.
15. Information provided by a sample of 13 CFD issuers<sup>2</sup> for five weeks between 16 March 2020 and 19 April 2020, amid heightened market volatility during the COVID-19 pandemic, shows that the proportion of their retail clients' trading accounts that lost money trading CFDs each week ranged between 56.9% and 63.2%.
16. As explained in [Consultation Paper 322](#) *Product intervention: OTC binary options and CFDs* (**CP 322**), retail clients' net financial losses in 2018 from trading CFDs with 60 licensed CFD issuers in Australia were a component of the \$1.5 billion gross trading revenue that the CFD issuers received in 2018. CFD issuers' gross trading revenue largely can be attributed to a combination of net client trading losses and spreads, fees and commissions charged to clients.<sup>3</sup>
17. Amid heightened market volatility during the COVID-19 pandemic, a sample of 13 CFD issuers<sup>4</sup> provided information about the number of their retail client accounts that made or lost money trading CFDs and the value of profits and losses they made in aggregate for five weeks between 16 March 2020 and 19 April 2020. In aggregate, the retail client accounts of the sampled CFD issuers made net losses of \$774,238,833 over the five-week period.
18. Liquidation or 'margin close-out' of retail clients' CFD positions by CFD issuers and the incidence of retail clients' trading accounts with 'negative equity' provide further evidence that CFDs have resulted in significant detriment to retail clients in the form of financial losses.

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<sup>2</sup> Together, the 13 CFD issuers in the sample have over 85% market share based on reported retail client money as at 28 February 2020.

<sup>3</sup> See [CP 322](#) at paragraph 70.

<sup>4</sup> Together, the 13 CFD issuers in the sample have over 85% market share based on reported retail client money as at 28 February 2020.

19. Most CFD issuers set a ‘liquidation level’ at which one or more of a client’s open CFD positions are liquidated or ‘closed out’ by the CFD issuer if the retail client does not have enough money in their CFD trading account to cover adverse movements on their position or to respond to margin calls. Many CFD issuers set the liquidation level at 50% of the total initial margin or variation margin required for the CFD positions on a client’s trading account. Retail clients who fail to ‘top up’ their account within the relatively short timeframe provided may see one or more of their CFD positions automatically closed out by the CFD issuer, crystallising losses.
20. Even if a CFD issuer sets a liquidation level for CFD positions, a retail client’s realised losses from liquidated positions may exceed their investment, which means they owe money to the issuer (‘negative equity’ or ‘negative balance’). For example, such outcomes may occur where there is price slippage or gapping.
21. Price ‘slippage’ may result from insufficient liquidity, where the price at which the CFD order is executed differs from the price quoted. Slippage can also occur where the market moves in the time between placement and execution of the CFD order. In these circumstances, a CFD order could be executed at an inferior price, increasing losses when closing out a CFD position.
22. ‘Gapping’, where the underlying market price moves in large and discrete steps and skips one or more price points, may prevent a CFD client from closing their CFD position at a chosen price limit between two price levels. Instead, the order to close the CFD position will be executed at the next available price determined by the CFD issuer. For example, several gapping events occurred in March 2020 due to heightened volatility in financial markets amid the COVID-19 pandemic.
23. Information provided to ASIC by 61 CFD issuers showed that during the period 1 January 2018 to 31 December 2018:
  - (a) over 9.3 million CFD positions (approximately 3.5% of all CFD positions) relating to retail client trading accounts were automatically closed out by CFD issuers. It can be inferred from the liquidation level having been reached that the retail clients holding these positions suffered losses of a significant proportion of their investment;
  - (b) over 41,000 CFD trading accounts (approximately 5.7% of CFD trading accounts) went into negative equity (i.e. these retail clients lost more than their investment amount and owed money to CFD issuers); and
  - (c) the total negative equity for those CFD trading accounts was over \$33 million (i.e. the total amount owed by those retail clients).
24. A sample of 13 CFD issuers provided information for five weeks between 16 March and 19 April 2020, amid heightened market volatility during the COVID-19 pandemic, about the number of margin close-outs relating to retail client accounts, the number of retail client accounts that went into negative balance and the aggregate negative balance value. In the five-week period, more than 1.1 million retail clients’ CFD positions were terminated under margin close-out arrangements once the funds in their trading accounts had reached a liquidation level. For more than 15,000 retail client CFD trading accounts that went into negative balance in the period, their realised losses from liquidated positions exceeded their invested amounts by more than \$10.9 million in aggregate. However, some of the CFD issuers advised that they forgave some or all of the negative balance amounts owed to them.

*Potential financial loss to retail clients resulting from CFDs*

25. CFDs are likely to result in significant detriment to retail clients in future:
- (a) because CFDs have an inherent risk of significant losses due to high leverage, including losses which can exceed a retail client's initial investment; and
  - (b) having regard to historical financial losses discussed above and CFD losses in other jurisdictions.
26. Leverage increases the sensitivity of a CFD position to the volatility of the price or level of the underlying. Leverage also increases the potential magnitude of retail client profits and losses and the speed at which such profits and losses may be incurred.
27. Leverage ratios are determined by CFD issuers based on various factors such as the liquidity of the underlying asset, market volatility, client position sizes and overall exposure of the CFD issuer.
28. It is common to see CFD leverage ratios of up to 200:1 for CFDs over stock market indices and up to 500:1 for CFDs over currency pairs. This means that, for example, at a leverage ratio of 500:1 a retail client with \$10,000 initial margin may open CFD positions with total exposure of \$5 million. Although the retail client only provides margin that is a fraction of the total notional value of the CFD position, they are entitled to the same gains and losses as if they paid 100% of the total notional value.
29. High leverage ratios also magnify CFD fees and costs (e.g. bid/ask spreads, commissions, overnight funding costs and currency conversion costs), which may significantly and quickly deplete a retail client's investment, because fees and costs are generally calculated based on total notional position value.
30. Analysis conducted by the UK Financial Conduct Authority's (FCA)<sup>5</sup> of trading data from November 2015 to October 2016 showed that for the currency pair USD/GBP, at a leverage ratio of 500:1 and a liquidation level set at 50%, retail clients who do not make an additional investment over a two-hour span would:
- (a) be automatically closed out on the losing side of the trade 81% of the time; and
  - (b) either lose all of, or more than, their initial margin 44% of the time.
31. As explained in CP 322, ASIC's linear regression analysis, based on CFDs over different underlying assets, showed that CFD leverage had a positive correlation to both client detriment metrics and issuer profitability.<sup>6</sup> That is, for a given CFD product category and CFD issuer, the level of retail client detriment (and issuer profitability) in that product increases as leverage does. The results were statistically significant, meaning that the relationship that was found between leverage and the dependent variables had a very low probability of occurring by chance.

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<sup>5</sup> FCA, [CP 16/40](#): *Enhancing conduct of business rules for firms providing contract for difference products to retail clients*, December 2016.

<sup>6</sup> See [CP 322](#) at paragraph 176.

32. An academic research paper by Rawley Heimer (Boston College) and Alp Simsek (Massachusetts Institute of Technology, National Bureau of Economic Research and Centre for Economic and Policy Research) (Heimer and Simsek 2019) provides causal evidence that the introduction of leverage limits by the US Commodity Futures Trading Commission (CFTC) reduced the underperformance of retail margin FX traders in the United States.<sup>7</sup> The limits were 50:1 for major currency pairs and 20:1 for minor currency pairs. The leverage limits reduced overall trading volume by 23%, while improving high-leverage traders' portfolio return by 18% per month and reducing brokerages' operating capital by 25%.
33. This academic research is further supported by the FCA's independent analysis of the impact of leverage limits on client outcomes using firm data. In its analysis of the European Securities and Markets Authority's (*ESMA*) leverage ratio limits (on which the leverage ratio limits in the order are based), the FCA found that the leverage ratio limits reduced:
- (a) total losses for retail clients of UK firms by £77.3 million between August and October 2018, equal to a projected reduction of £309.1 million per year;
  - (b) the number of active retail clients by 72,783 (although it noted that a proportion of this may be due to client activity that has moved to other jurisdictions);
  - (c) the number of automatic margin close-outs for retail clients by 99.5% between August and October 2017 and the same period in 2018; and
  - (d) the total amount of debt forgiven by firms because retail clients went into negative equity by £33.4 million.<sup>8</sup>
34. Further, in February 2020, ESMA advised<sup>9</sup> the European Commission on the effects of product intervention measures similar to those in the order, summarising the following observed effects of its temporary measures on retail clients:
- (a) the number of CFD retail client accounts, trading volume and total retail client equity decreased;
  - (b) the proportion of profitable retail client accounts remained broadly stable;
  - (c) average costs incurred by retail clients while trading CFDs were significantly lower; and
  - (d) a sustained decrease in the number of automatic close-outs, the number of times retail client accounts went into negative equity and the size of negative equity balances.
35. Research into client outcomes from trading CFDs in other jurisdictions, summarised in CP 322, provides further evidence that CFDs are likely to result in significant detriment to retail clients.<sup>10</sup>

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<sup>7</sup> See Rawley Z Heimer and Alp Simsek 2019, 'Should retail investors' leverage be limited?', *Journal of financial economics*, vol 132, no 3.

<sup>8</sup> FCA, [CP 18/38: Restricting contract for difference products sold to retail clients and a discussion of other retail derivative products](#), PDF 1001 KB, December 2018, paragraphs 3.36–3.37.

<sup>9</sup> ESMA, [Technical advice to the Commission on the effects of product intervention measures](#), PDF 425 KB, final report, 3 February 2020.

<sup>10</sup> [CP 322](#), paragraphs 92 and 93 which set out findings of losses incurred by retail clients trading CFDs in the United Kingdom, Ireland, Cyprus, Spain and Poland.

*The impact the detriment has had, or will or is likely to have, on retail clients*

36. Financial losses impact individuals differently depending on their personal circumstances. Other consequences may flow from financial losses from CFD trading, such as difficulty meeting other financial commitments and family and relationship stresses. In complaints to ASIC, retail clients have reported having to access funds from their superannuation accounts, credit cards or home loans to cover large CFD trading losses.
37. The evidence of the nature and extent of the financial losses to retail clients resulting from CFDs demonstrates that the financial losses resulting from CFDs have had and are likely to have a significant impact on retail clients.

*Demographics of clients who trade CFDs and complaints*

38. The information in Section B of CP 322 about client demographics and complaints relates generally to the retail over-the-counter (*OTC*) derivatives market and is not evidence of significant detriment to retail clients resulting from CFDs. Section B of CP 322 is relevant to provide market background and colour, and evidences that CFDs are available for acquisition by issue to retail clients.

## Consultation

39. On 22 August 2019, ASIC published a public consultation paper, [CP 322](#), setting out proposals to exercise the product intervention power in Part 7.9A of the Act to make certain market-wide product intervention orders relating to the issue and distribution of OTC binary options and CFDs to retail clients.
40. The proposed product intervention order relating to CFDs (*proposed CFD order*) set out proposed conditions (*CP 322 conditions*) on the issue and distribution of CFDs to retail clients (see Attachment 1 to CP 322 and Table 1 below) and provided for CFD issuers to notify existing retail clients of the terms of the order. CP 322 proposed that the proposed CFD order would remain in force for 18 months.

**Table 1: CP 322 conditions on the issue and distribution of OTC CFDs to retail clients**

CP 322 condition	Summary of CP 322 condition	Proposed commencement
<b>1. Leverage ratio limits</b>	<p>Minimum initial margin requirements on CFDs issued to retail clients are applied such that leverage ratios<sup>11</sup> offered to retail clients do not exceed the following limits at the time of issue:</p> <ul style="list-style-type: none"> <li>• 20:1 for CFDs over currency pairs or gold;</li> <li>• 15:1 for CFDs over stock market indices;</li> <li>• 10:1 for CFDs over commodities (excluding gold);</li> <li>• 2:1 for CFDs over crypto-assets; and</li> <li>• 5:1 for CFDs over shares or other underlying assets</li> </ul> <p>The leverage ratio limits take into account any leverage</p>	20 business days after the day on which the legislative instrument is registered

<sup>11</sup> A leverage ratio is the ratio between the total notional value of a CFD position and the margin required to open and maintain the CFD position.

CP 322 condition	Summary of CP 322 condition	Proposed commencement
	inherent in an underlying reference asset (e.g. a CFD on a futures contract, an option contract or a leveraged exchange traded fund)	
<b>2. Margin close-out protection</b>	The terms of a CFD offered to a retail client must provide that, if a retail client's funds in their CFD trading account fall to less than 50% of the total initial margin required for all of their open CFD positions on that account, a CFD issuer must, as soon as market conditions allow, close out one or more open CFD positions held by the retail client	Three months after the day on which the legislative instrument is registered
<b>3. Negative balance protection</b>	The terms of a CFD offered to a retail client must limit the retail client's losses on CFD positions to the funds in that retail client's CFD trading account	20 business days after the day on which the legislative instrument is registered
<b>4. Prohibition on inducements</b>	A person must not, in the course of carrying on a business, give or offer a gift, rebate, trading credit or reward to a retail client or a prospective retail client as an inducement to open or fund a CFD trading account or trade CFDs  However, the prohibition would not cover information services or educational or research tools	20 business days after the day on which the legislative instrument is registered
<b>5. Risk warnings</b>	A CFD issuer must provide a prominent risk warning to retail clients and prospective retail clients on all account opening forms, product disclosure statements ( <i>PDSs</i> ), any trading platforms maintained by the CFD issuer and websites relating to CFD trading which, at a minimum: <ul style="list-style-type: none"> <li>includes a warning on the complexity, risks and likelihood of losses; and</li> <li>discloses the percentage of the CFD issuer's retail clients' CFD trading accounts that made a loss over a 12-month period</li> </ul>	20 business days after the day on which the legislative instrument is registered (except trading platform risk warnings)  Trading platform risk warnings: three months after the day on which the legislative instrument is registered
<b>6. Real-time disclosure of total position size</b>	A CFD issuer must provide real-time disclosure to a retail client, in any trading platforms maintained by the CFD issuer, of the retail client's total position size in monetary terms for all open CFD positions for the retail client's CFD trading account	Three months after the day on which the legislative instrument is registered
<b>7. Real-time disclosure of overnight funding costs</b>	If a CFD issuer charges a retail client funding costs for holding open CFD positions overnight, the CFD issuer must clearly and prominently disclose, in any trading platforms maintained by the CFD issuer, applicable overnight funding costs to the retail client, both as an annualised rate of interest and as an estimated cost expressed in the currency denomination of the CFD	Three months after the day on which the legislative instrument is registered
<b>8. Transparent pricing and execution</b>	A CFD issuer must maintain and make available on its website a CFD pricing methodology and a CFD execution policy  The CFD pricing methodology must explain how the CFD issuer determines its CFD prices, including:	Three months after the day on which the legislative instrument is registered

CP 322 condition	Summary of CP 322 condition	Proposed commencement
	<ul style="list-style-type: none"> <li>• how it uses independent and externally verifiable price sources;</li> <li>• how it applies any spread or mark-up; and</li> <li>• any circumstances under which its CFD prices will vary from the methodology</li> </ul> <p>The CFD execution policy must explain how the CFD issuer deals with clients' offers to trade CFDs and effects CFD trades</p>	

41. CP 322 sought the following feedback:

*Your feedback*

- F1Q1 Do you agree with our proposal to make a market-wide product intervention order which imposes Conditions 1–8 (set out in Table 5) on the issue and distribution of CFDs to retail clients? If not, why not? If you disagree that CFDs have resulted in, and are likely in future to result in, significant detriment to retail clients, please provide evidence and data in support of your view.
- F1Q2 Condition 2 would require the terms of a CFD to provide that a CFD issuer must close out one or more of a retail client's open CFD positions, if the retail client's funds in their CFD trading account fall to less than 50% of their total initial margin required for all of their open CFD positions on that account. Do you agree with this condition or would it be better for clients (and operationally easier) if the CFD issuer is required to close all of the retail client's open CFD positions?
- F1Q3 Condition 5 would require a CFD issuer to provide a prominent risk warning on account opening forms, trading platforms maintained by the CFD issuer, websites and the front page of PDSs. Do you agree with this condition? Do you think a risk warning should also be required on all advertising and marketing material?
- F1Q4 Do you agree with our proposal that the order would remain in force for a period of 18 months? If not, why not?
- F1Q5 Do you agree that our proposed delayed commencement of the order is appropriate, balancing the time it will take to implement the order and the nature, likelihood and extent of the significant consumer detriment? If not, what is an appropriate period?
- F1Q6 Do you agree with our identification of the effects that making the proposed product intervention order will have on competition in the financial system? If not, why not?

42. ASIC received over 400 submissions relating to the proposed CFD order in CP 322, including submissions from CFD issuers, industry bodies, consumer groups, CFD consumers and members

of the public. Additionally, ASIC met with a number of CFD issuers between December 2019 and February 2020 to discuss their submissions and to request cost estimates.

43. The [submissions to CP 322](#) are publicly available on ASIC's website, excluding confidential submissions.
44. Respondents' views on each of the CP 322 conditions can be summarised as follows.

*Leverage ratio limits (CP 322 condition 1)*

45. Submissions generally agreed that excessive leverage can lead to poor consumer outcomes. Consumer groups strongly supported the proposal, saying that the changes would make CFDs safer products, even if for some this would involve a reduction in consumer choice. However, the vast majority of respondents opposed the leverage ratio limits proposed in CP 322 condition 1, including submissions that the limits were too restrictive, would increase the costs of using CFDs for hedging investment risks and risked driving retail clients offshore in order to access higher leverage. CFD issuers raised concerns that the limits proposed in CP 322 condition 1 would cause a significant decline in their revenue from CFDs.
46. Many submissions, including nearly all CFD issuer submissions, suggested alternative leverage ratio limits for retail clients, ranging from 200:1 for CFDs of major currency pairs and major stock market indices to 2:1 for CFDs over crypto-assets. Among these submissions were some that supported leverage ratio limits aligned with limits in force in certain other jurisdictions (e.g. United States, Japan or the European Union).
47. Around 45 submissions suggested an 'experienced retail client' classification permitting higher CFD leverage (e.g. up to 100:1), pointing to rules in force in Poland<sup>12</sup> (and proposals considered and not implemented in the United Kingdom<sup>13</sup> and Cyprus<sup>14</sup>). Many of these submissions suggested that all other retail clients should be subject to leverage ratio limits that are aligned with restrictions in the EU. Some submissions suggested 'experienced retail client' criteria relating to income or assets, trading experience and self-certification of matters related to understanding of CFDs and their risks, while some others suggested mandatory training or education for new CFD clients. The submissions did not indicate what proportion of CFD issuers' retail clients would qualify as 'experienced' retail clients or provide evidence that allowing retail clients with more trading experience a higher leverage ratio would not involve a likelihood of significant detriment for those clients, that would be reduced by applying a lower leverage ratio.
48. Some CFD issuers did not see a place for client classifications additional to the classification of retail clients (s761G) and wholesale clients under existing laws (including 'sophisticated investors' (s761GA), 'professional investors' (s761G(7)(d)) or other wholesale clients (s761G(7))).

*Mandatory close-out protection (CP 322 condition 2)*

49. Respondents' views were evenly split on margin close-out protection, with CFD issuers generally supportive and around two-thirds of consumers who gave feedback on this proposed condition

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<sup>12</sup> See [Communication from the KNF Board on the introduction of additional requirements for offering contracts for differences \(CFDs\) to retail clients](#), PDF 488 KB, KNF, 1 August 2019.

<sup>13</sup> See [PS19/18 Restricting contract for difference products sold to retail clients](#), FCA, July 2019.

<sup>14</sup> See [Policy statement on the imposition of national measures in relation to the marketing, distribution and sale of CFDs](#), PDF 1.07 MB, 27 September 2019.

opposed. Some submissions raised concerns that retail clients may suffer additional transaction costs in re-entering CFD positions automatically closed out by CFD issuers under the proposed condition.

50. A couple of CFD issuers suggested technical changes to margin close out protection to allow an additional method of calculating the aggregate close out protection amount.

*Negative balance protection (CP 322 condition 3)*

51. Submissions across all stakeholder groups broadly agreed with negative balance protection. For example, consumer groups said it would be a significant and welcome protection that will improve the customer experience and actively prevent consumer detriment. However, some CFD issuers raised concerns about ‘moral hazard’ and that this protection would encourage retail clients to engage in more risky trading strategies. Some CFD issuers also noted negative balance protection would impact their risk management processes.

*Prohibition on inducements (CP 322 condition 4)*

52. Submissions across all stakeholder groups, including CFD issuers, broadly agreed with this proposed condition. However, a number of CFD issuers advocated for a carve-out for hospitality and certain types of volume-based rebates of fees and costs to retail clients. Industry groups and some CFD issuers also submitted that such inducements are commonplace for other financial products and financial services and that the proposed prohibition of inducements was unfair and potentially anti-competitive.

*Risk warnings (CP 322 condition 5)*

53. Respondents broadly agreed with the proposed risk warnings. Some respondents, including AFCA, considered that prominent risk warnings should be provided on all forms of CFD marketing and information provided by CFD issuers. Consumer groups strongly supported inclusion of issuer-specific information in risk warnings, but cautioned that risk warnings are not a substitute for safe products. They said, if written in a broad way, risk warnings are unlikely to have an effect on consumer decision making.
54. Several CFD issuers raised practical issues with the proposed risk warnings and suggested changes regarding the implementation of the warnings, particularly how and where they would be displayed.

*Real-time disclosure of total exposure (CP 322 condition 6)*

55. Most submissions did not comment on this proposed condition. The feedback was generally supportive of the proposed disclosure enhancement, although there were differing views from stakeholders as to retail clients’ understanding of total CFD exposure. Some CFD issuers also commented that they already show similar information on their trading platforms.

*Real-time disclosure of overnight funding costs (CP 322 condition 7)*

56. Most submissions did not comment on this proposed condition. Several CFD issuers acknowledged the benefits of cost transparency but raised concerns that this condition would involve significant implementation costs. Some CFD issuers further submitted that the proposed

condition was unfair as it would only apply to CFD issuers who maintained a trading platform and not to CFD issuers who offer trading on popular third-party platforms.

57. One CFD issuer suggested an alternative measure to require CFD issuers to disclose (e.g. on a webpage) their historical overnight funding costs for each product. The alternative measure was broadly supported by the CFD issuers consulted between December 2019 and February 2020.

*Transparent pricing and execution methodology (CP 322 condition 8)*

58. Submissions across all stakeholder groups broadly agreed with this proposed condition. One CFD issuer disagreed, submitting that retail clients are already provided with a significant amount of information under existing disclosure requirements.

**Summary of the order**

59. The order imposes certain conditions on issuing and other specified dealing in CFDs in relation to retail clients (section 5 of the order), prohibits giving or offering specified benefits to retail clients or prospective retail clients in specified circumstances (section 6 of the order) and requires CFD issuers to take reasonable steps to notify their retail clients of the terms of the order (section 8 of the order). Table 2 summarises the conditions specified in the order and the prohibition on giving or offering a prohibited benefit, noting key differences from the proposed CFD order.

**Table 2: Summary of conditions specified in the order**

Condition	Summary of condition	Applies from
<b>1. Leverage ratio limits</b> <b>(See subsections 7(1) and 7(2) of the order)</b>	<p>Minimum initial margin requirements on CFDs issued to retail clients are applied such that leverage ratios offered to retail clients do not exceed the following limits at the time of issue:</p> <ul style="list-style-type: none"> <li>• 30:1 for CFDs over an exchange rate for a major currency pair (cf. 20:1 for all currency pairs in the proposed CFD order);</li> <li>• 20:1 for CFDs over an exchange rate for a minor currency pair, gold or a major stock market index (cf. 15:1 for all stock market indices in the proposed CFD order);</li> <li>• 10:1 for CFDs over commodities (excluding gold) or a minor stock market index (cf. 15:1 for all stock market indices in the proposed CFD order);</li> <li>• 2:1 for CFDs over crypto-assets; and</li> <li>• 5:1 for CFDs over shares or other underlying assets</li> </ul> <p>The leverage ratio limits take into account any leverage inherent in an underlying reference asset (e.g. a CFD on a futures contract, an option contract or a leveraged exchange traded fund)</p>	<p>29 March 2021</p> <p>(cf. 20 business days in the proposed CFD order)</p>

Condition	Summary of condition	Applies from
<p><b>2. Margin close-out protection</b></p> <p>(See subsections 7(3) and 7(4) of the order)</p>	<p>The terms of a CFD offered to a retail client must provide that, if at any time the net equity of the retail client's CFD trading account is less than 50% of the total initial margin or total margin required for all of their open CFD positions on that account (see definition of <i>aggregate close-out protection amount</i>), the CFD issuer must, as soon as market conditions allow, close out one or more open CFD positions held by the retail client until the net equity of the retail client's CFD trading account is equal to or greater than the aggregate close-out protection amount for the remaining open CFD positions or all of the CFD positions permitted to be terminated under this condition have been terminated</p> <p>(Margin close-out protection in the proposed CFD order did not provide for calculation by reference to total margin)</p>	<p>29 March 2021</p> <p>(cf. three months after the day on which the legislative instrument is registered in the proposed CFD order)</p>
<p><b>3. Negative balance protection</b></p> <p>(See subsection 7(5) of the order)</p>	<p>The terms of a CFD offered to a retail client must limit the retail client's losses on CFD positions to the funds in that retail client's CFD trading account</p> <p>(Unchanged from CP 322 condition 3)</p>	<p>29 March 2021</p> <p>(cf. 20 business days in the proposed CFD order)</p>
<p><b>4. Prohibition on inducements</b></p> <p>(See section 6 of the order)</p>	<p>A person must not, in the course of carrying on a business, give or offer a gift, discount, rebate, trading credit or reward to a retail client or a prospective retail client as an inducement to open or fund a CFD trading account or trade CFDs</p> <p>However, the prohibition does not cover:</p> <p>(a) information services or educational or research tools; or</p> <p>(b) discounts of fees and costs (including volume-based discounts) that are offered to all retail clients and prospective retail clients</p> <p>(The CP 322 CFD proposal did not expressly prohibit rebates or carve out discounts of fees and costs in (b) above)</p>	<p>29 March 2021</p> <p>(cf. 20 business days in the proposed CFD order)</p>

60. In the order, an exchange rate for a major currency pair is an exchange rate for a pair of currencies that consists of any two of the following: Australian dollar, British pound, Canadian dollar, euro, Japanese yen, Swiss franc and US dollar. A minor currency pair means any currency pair that is not a major currency pair.

61. A major stock market index is defined in the order to mean any of the following stock market indices:

- (a) CAC 40;
- (b) DAX;
- (c) Dow Jones Industrial Average;
- (d) EURO STOXX 50 Index;

- (e) FTSE 100;
- (f) NASDAQ-100 Index;
- (g) NASDAQ Composite Index;
- (h) Nikkei Stock Average;
- (i) S&P 500; and
- (j) S&P/ASX 200.

62. In the order, a minor stock market index means any stock market index that is not a major stock market index.

*Notification of the order to retail clients*

63. Section 8 of the order requires that a CFD issuer that has issued a CFD to a retail client in the 12 months before commencement of the order must take reasonable steps to notify each such retail client of the terms of the order as soon as practicable and in any case within 10 business days after the commencement of the order.

*Omission of CP 322 conditions 5–8*

64. The order omits the risk warnings and disclosure measures proposed in CP 322 conditions 5–8.

*Jurisdictional scope*

65. For clarity, the jurisdictional scope of the order is expressly set out in subsections 5(6)–(9) of the order. No jurisdictional scope was expressly specified in the draft order annexed to CP 322.

**Why the order is an appropriate way of reducing the detriment**

66. The notice now describes why the order is an appropriate way of reducing the detriment.

- (a) The leverage ratio limits are expected to reduce the size and speed of retail clients' CFD losses by reducing CFD exposure and the sensitivity of CFDs to market volatility.
- (b) Margin close-out protection is expected to standardise a common risk management feature that acts as a circuit breaker to close out one or more of the open CFDs connected to a retail client's CFD trading account in circumstances where the retail client has lost a substantial proportion of the funds in that trading account.
- (c) Negative balance protection is expected to standardise a risk management feature offered by some CFD providers that protects retail clients by limiting their losses on CFD positions to the funds in their CFD trading account.
- (d) The order prohibits offering or giving specified inducements to retail clients and prospective retail clients that encourage higher trading volumes and can distract them from the risks of trading CFDs, while not barring discounts of fees and costs that are offered to all retail clients and prospective retail clients.
- (e) It is appropriate to omit from the order the risk warnings and disclosure measures proposed in CP 322 conditions 5–8 because:

- (i) the other policy measures in the order are appropriate and are expected to achieve the objective of reducing the risk of significant detriment to retail clients resulting from CFDs;
  - (ii) anticipated benefits of the proposed risk warnings and disclosures on detriment to retail clients are tempered by consideration of academic research and anecdotal evidence showing that risk warnings and disclosure can be less effective than expected or ineffective (see [Report 632 Disclosure: Why it shouldn't be the default](#)); and
  - (iii) the significant implementation costs estimated for the proposed risk warnings and disclosure measures (informed by the consultation submissions) are not justified by the expected benefits of the warnings and disclosures.
- (f) Maintaining the status quo would not achieve the objective of reducing the risk of significant detriment to retail clients resulting from CFDs.
  - (g) The expected benefits of the order to retail clients from reducing the risk of significant detriment resulting from CFDs outweigh the expected costs to retail clients (including reduced consumer choice and increased costs of using CFDs for hedging).
  - (h) Professional, sophisticated and other wholesale clients are not affected by the order.
  - (i) The order is consistent with regulatory measures in force in other jurisdictions (e.g. it is most closely aligned with regulatory measures in the United Kingdom and the European Union), which will promote confident participation in the Australian financial system.
  - (j) The expected net benefits to retail clients from the order, and additional regulatory benefit from improved trust and confidence in the Australian financial system and economy over time, are expected to outweigh the expected significant impact to CFD issuers and other businesses dealing in CFDs, including to their revenue from dealing in CFDs in relation to retail clients and their costs of compliance with the order.
  - (k) The impact of the order on CFD issuers and other businesses dealing in CFDs is expected to be lower than the impact of the proposed CFD order (set out in CP 322) on the issuers and other businesses because:
    - (i) significant costs associated with CP 322 conditions 5–8 will not be incurred;
    - (ii) the leverage ratio limits in the order are expected to have less impact on CFD trading volumes and CFD issuer trading revenue;
    - (iii) technical amendments to the margin close-out protection measure in the order will reduce implementation costs for some CFD issuers.
  - (l) The order is more equitable as between CFD issuers than the proposed CFD order.
  - (m) The order is not expected to have any material effect on underlying financial markets.

67. The order is appropriate in ensuring consistency with:

- (a) the main object of Chapter 7 of the Act, including the promotion of confident and informed decision-making by consumers of financial products and services while facilitating efficiency, flexibility and innovation in the provision of those products and services (paragraph 760A(a) of the Act); and

- (b) ASIC's regulatory objectives set out in subsection 1(2) of the *Australian Securities and Investments Commission Act 2001*, particularly ASIC's obligations to strive to:
  - (i) maintain, facilitate and improve the performance of the financial system and the entities within that system in the interests of commercial certainty, reducing business costs, and the efficiency and development of the economy; and
  - (ii) promote the confident and informed participation of investors and consumers in the financial system.

68. The order is appropriate in striking a balance between:

- (a) reducing the risk of significant detriment to retail clients resulting from CFDs;
- (b) the financial and other impact of the order on retail clients, CFD issuers and distributors and government; and
- (c) any likely effects on competition in the Australian financial system.

## Statement of Compatibility with Human Rights

This Statement of Compatibility with Human Rights is prepared in accordance with Part 3 of the *Human Rights (Parliamentary Scrutiny) Act 2011*.

### ***ASIC Corporations (Product Intervention Order—Contracts for Difference) Instrument 2020/986***

#### Overview

1. The instrument is a product intervention order made under subsection 1023D(3) of the *Corporations Act 2001* (the Act). The order imposes certain conditions in relation to specified dealings in over-the-counter (OTC) contracts for difference (CFDs) (a class of financial product) in relation to retail clients, prohibits giving or offering a certain benefit to retail clients or prospective retail clients in specified circumstances and requires CFD issuers take reasonable steps to notify its retail clients of the terms of the instrument.
2. Under subsection 1023D(3) of the Act, if ASIC is satisfied that a class of financial product:
  - (a) is, or is likely to be, available for acquisition by issue, or for regulated sale, to persons as retail clients (whether or not it also is, or is likely to be, available for acquisition by persons as wholesale clients); and
  - (b) has resulted in, or will or is likely to result in, significant detriment to retail clients;ASIC may, by legislative instrument, order that a person must not engage in specified conduct in relation to the class of financial products, either entirely or except in accordance with conditions specified in the order.
3. A description of the significant detriment is set out in Attachment A, the Product Intervention Order Notice.
4. The instrument has been made to reduce the risk of significant detriment to retail clients resulting from OTC CFDs.
5. The orders in the instrument will remain in force for 18 months from the day the instrument commences, subject to the Court making an order staying or otherwise affecting the operation of the orders: see subsection 1023G(2) of the Act. The duration of the instrument may be extended beyond 18 months, but only in accordance with section 1023H of the Act (which requires a declaration, made by legislative instrument, in accordance with written approval from the Minister).

#### Assessment of human rights implications

2. The instrument does not engage any of the applicable rights or freedoms.

## Conclusion

3. *ASIC Corporations (Product Intervention Order–Contracts for Difference) Instrument 2020/986* is compatible with the human rights and freedoms recognised or declared in the international instruments listed in section 3 of the *Human Rights (Parliamentary Scrutiny) Act 2011*.