



**ASIC**

Australian Securities & Investments Commission

## REGULATORY GUIDE 227

# Over-the-counter contracts for difference: Improving disclosure for retail investors

August 2011

### **About this guide**

This guide is for those involved with the issue, sale or advertising of over-the-counter contracts for difference (OTC CFDs), margin forex and similar products to retail investors. It may also be of interest to issuers of exchange-traded CFDs.

It sets out guidelines for improved disclosure to retail investors to help them understand and assess these products. It also provides guidance on the advertising of OTC CFDs to retail investors.

### About ASIC regulatory documents

In administering legislation ASIC issues the following types of regulatory documents.

**Consultation papers:** seek feedback from stakeholders on matters ASIC is considering, such as proposed relief or proposed regulatory guidance.

**Regulatory guides:** give guidance to regulated entities by:

- explaining when and how ASIC will exercise specific powers under legislation (primarily the Corporations Act)
- explaining how ASIC interprets the law
- describing the principles underlying ASIC's approach
- giving practical guidance (e.g. describing the steps of a process such as applying for a licence or giving practical examples of how regulated entities may decide to meet their obligations).

**Information sheets:** provide concise guidance on a specific process or compliance issue or an overview of detailed guidance.

**Reports:** describe ASIC compliance or relief activity or the results of a research project.

### Document history

This guide was issued in August 2011 and is based on legislation and regulations as at the date of issue.

### Disclaimer

This guide does not constitute legal advice. We encourage you to seek your own professional advice to find out how the Corporations Act and other applicable laws apply to you, as it is your responsibility to determine your obligations.

Examples in this guide are purely for illustration; they are not exhaustive and are not intended to impose or imply particular rules or requirements.

In providing this guidance, ASIC seeks to improve the disclosure given to retail investors to ensure they have all the information they need to make an informed investment decision. However, this guide should not be regarded as an indication that ASIC regards these products as being suitable for all or most retail investors.

# Contents

<b>A</b>	<b>Overview</b> .....	<b>4</b>
	Contracts for difference, margin forex and retail investors .....	4
	Who this guide applies to.....	5
	Improving disclosure on OTC CFDs .....	6
	Advertising CFDs .....	10
	Timeline for implementing improved disclosure .....	11
<b>B</b>	<b>The disclosure benchmarks</b> .....	<b>13</b>
	Benchmark 1: Client qualification .....	13
	Benchmark 2: Opening collateral .....	15
	Benchmark 3: Counterparty risk—Hedging .....	16
	Benchmark 4: Counterparty risk—Financial resources .....	17
	Benchmark 5: Client money.....	19
	Benchmark 6: Suspended or halted underlying assets .....	20
	Benchmark 7: Margin calls .....	21
	Summary of disclosure benchmarks .....	22
<b>C</b>	<b>Implementing the disclosure benchmarks</b> .....	<b>25</b>
	Providing upfront and ongoing disclosure .....	25
	Updating existing investors.....	26
	Upfront disclosure for new investors .....	26
	Ongoing disclosures .....	28
	<b>Appendix: Questions a potential investor should ask a CFD provider</b> .	<b>30</b>
	<b>Key terms</b> .....	<b>31</b>
	<b>Related information</b> .....	<b>33</b>

## A Overview

### Key points

ASIC has developed seven disclosure benchmarks for over-the-counter contracts for difference (OTC CFDs) that can help retail investors understand the risks associated with these products, assess their potential benefits and decide whether investment in the products is suitable for them: see RG 227.14–RG 227.17 and Table 1.

An issuer of OTC CFDs to retail investors should address the benchmarks in its disclosure on an ‘if not, why not’ basis: see RG 227.19–RG 227.24.

An issuer and those involved in the sale of CFDs should also ensure that advertising is consistent with information provided in disclosure documents: see RG 227.31–RG 227.34.

Existing issuers should refer to the benchmarks in new Product Disclosure Statements (PDSs), updated disclosure and ongoing disclosure on an ‘if not, why not’ basis.

## Contracts for difference, margin forex and retail investors

RG 227.1 Contracts for difference (CFDs) are leveraged derivative products that allow investors trading in them to take a position on the change in the value of an underlying asset. Margin forex instruments are economically equivalent products that have currencies as the underlying asset.

RG 227.2 References in this guide to CFDs include references to margin forex and CFD or margin-forex-type products, such as margin commodity products. The benchmarks do not apply to options, warrants, swaps or futures, or to forwards not offering the same degree of leverage as CFDs or margin forex.

RG 227.3 In Australia, most CFDs are not traded on an exchange—they are issued as over-the-counter (OTC) products. They are generally marketed to, and traded by, retail investors. Many of these retail investors do not seek or receive financial advice before deciding to invest, instead relying on advertising and disclosure materials to inform their decision to invest.

Note: This guide uses the term ‘retail investor’ to refer to people who trade in CFDs, with the same meaning as ‘retail client’ as defined in s761G and 761GA of the *Corporations Act 2001* (Corporations Act).

RG 227.4 In developing this guide, ASIC conducted a ‘health check’ of the CFD market, including examining issuers’ business models, disclosure documents and advertising, and investors’ attitudes, behaviours and experience. Our

findings are summarised in our report *Contracts for difference and retail investors* (REP 205).

- RG 227.5 Our research suggests that many retail investors do not fully understand the risks of trading in CFDs. This is partly due to the inherent complexity of the subject matter. However, we have also found that disclosure documents are often difficult to understand, and do not highlight key information.
- RG 227.6 Retail investors are often attracted to CFDs in anticipation of promised high rates of return for limited initial capital outlay. However, we regard CFDs as being complex products with a number of inherent risks. For example, CFDs are often highly leveraged, which means that investors can take on a high degree of market risk with only a relatively small initial deposit. This degree of leverage raises the risk that even small adverse movements in the value of the underlying asset can lead to losses on the CFD position that exceed the capital initially provided by investors.
- RG 227.7 We are concerned that this complexity and risk means that these types of product are unlikely to be appropriate for the investment objectives, needs and risk profile of many retail investors.
- RG 227.8 Given that most retail investors do not obtain personal financial advice before investing in CFDs, instead relying solely on information provided in disclosure documents, it is crucial to ensure that these disclosure documents are of a high quality and contain all the information that investors require to make an informed decision. This guide seeks to improve disclosure on OTC CFDs to ensure that retail investors are provided with documents of this standard. However, this guide should not be regarded as an indication that ASIC regards these products as being suitable for all or most retail investors.

## Who this guide applies to

- RG 227.9 This guide is for issuers of OTC CFDs, and those responsible for preparing a Product Disclosure Statement (PDS) for an offer of OTC CFDs.

Note: Section 1013A of the Corporations Act sets out who is responsible for preparing a PDS in various circumstances.

- RG 227.10 This guide does not discuss exchange-traded products. We consider that there are some specific risks associated with trading in OTC products that are not a feature of exchange-traded products. These include the counterparty risk derived from trading without the procedures and guarantees of an exchange. Nevertheless, exchange-traded CFDs are still complex leveraged products that expose investors to the risk of significant losses resulting from market movements. An issuer of exchange-traded CFDs may also wish to consider whether any of the benchmarks in this

guide are relevant to its disclosure documents and advertising, as a matter of best practice disclosure.

## Improving disclosure on OTC CFDs

### The role of disclosure

- RG 227.11 The disclosure framework in the Corporations Act requires an issuer of CFDs and other derivatives to:
- (a) disclose upfront to retail investors all the information they reasonably need to know in order to make a decision about whether or not to acquire the product; and
  - (b) provide ongoing disclosure about material matters to help retail investors monitor whether their expectations are being met.
- RG 227.12 Disclosure is not designed to stop retail investors from taking investment risks, but to help them understand the risks involved in any particular investment or type of investment. This enables them to make an informed decision about whether the potential reward (the return on their investment) matches the level of risk involved, and whether they are prepared to take on that risk.
- RG 227.13 Given the risks for retail investors associated with CFDs, and the fact that many rely on advertising and disclosure material to inform their decision to invest, we think that it is necessary to ensure that disclosure provides retail investors with all the information they need to make an informed investment decision. This may include a decision not to invest in these products in some cases.

### Benchmark disclosure

- RG 227.14 The benchmark disclosure model:
- (a) identifies, for a particular financial product, the key risk areas potential investors should understand before making a decision to invest;
  - (b) sets a benchmark for how a product issuer should address these risks in establishing its business model and compliance procedures; and
  - (c) sets out ASIC's expectation that an issuer will state in the PDS and other disclosures whether it meets the benchmark, and if not, why not.

This model of disclosure provides concrete standards by which retail investors can assess financial products for which there are typically few such external benchmarks.

RG 227.15 We have decided that it is appropriate to extend the benchmark model of disclosure, which we have previously applied to other products, to OTC CFDs issued to retail investors. Some of the benchmarks may also be of interest—as best practice disclosure—to issuers of exchange-traded CFDs.

Note: See Regulatory Guide 45 *Mortgage schemes: Improving disclosure for retail investors* (RG 45), Regulatory Guide 46 *Unlisted property schemes: Improving disclosure for retail investors* (RG 46) and Regulatory Guide 69 *Debentures and unsecured notes: Improving disclosure for retail investors* (RG 69) for other examples of the benchmark disclosure approach.

### The seven disclosure benchmarks

RG 227.16 We have developed seven disclosure benchmarks: see Table 1 and Section B. We expect the benchmarks to be addressed (as applicable) and, if not addressed, explained on an ‘if not, why not’ basis: see RG 227.19 and Section B, Table 3. We also expect any advertising to support the use of these benchmarks: see RG 227.31–RG 227.34.

RG 227.17 The seven benchmarks address key issues that we think should be:

- (a) highlighted in disclosure relating to OTC CFDs; and
- (b) discussed in a manner that allows prospective retail investors to make an informed decision about whether to invest.

**Table 1: Benchmarks for OTC CFDs issued to retail investors**

<b>1 Client qualification</b>	Benchmark 1 addresses the issuer's policy on investors' qualification for CFD trading.
<b>2 Opening collateral</b>	Benchmark 2 addresses the issuer's policy on the types of assets accepted from investors as opening collateral.
<b>3 Counterparty risk—Hedging</b>	Benchmark 3 addresses the issuer's practices in hedging its risk from client positions and the quality of this hedging.
<b>4 Counterparty risk—Financial resources</b>	Benchmark 4 addresses whether the issuer holds sufficient liquid funds to withstand significant adverse market movements.
<b>5 Client money</b>	Benchmark 5 addresses the issuer's policy on its use of client money.
<b>6 Suspended or halted underlying assets</b>	Benchmark 6 addresses the issuer's practices in relation to investor trading when trading in the underlying asset is suspended or halted.
<b>7 Margin calls</b>	Benchmark 7 addresses the issuer's practices in the event of client accounts entering into margin call.

RG 227.18 In addition to these benchmarks, we have also developed an investor guide, *Thinking of trading contracts for difference (CFDs)?*, to better enable potential investors to understand the nature of CFD trading and assess whether it is likely to be suitable for them. This includes a series of questions

we suggest potential investors should ask an issuer about its business model (reproduced as an Appendix to this guide). We expect that potential investors will be able to use the PDS to answer these questions.

### **Disclosure against the benchmarks—‘if not, why not’**

RG 227.19 An issuer should address the benchmarks in its disclosure on an ‘if not, why not’ basis. This means stating that the issuer either:

- (a) meets the benchmark; or
- (b) does not meet the benchmark, and explaining why not.

RG 227.20 ‘Why not’ means explaining how an issuer deals with the business factor or concern underlying the benchmark (including the alternative systems and controls the issuer has in place to deal with the concern). The disclosure required against each benchmark is summarised in Section B, Table 3.

Note: If a benchmark contains multiple requirements, and an issuer cannot meet all requirements under the benchmark, it should state that it does not meet the benchmark and clearly explain why it did not meet the particular requirements.

RG 227.21 Failing to meet one or more of these benchmarks does not mean that a product provided by a particular issuer necessarily represents a poor investment. However, the issuer will need to explain what alternative measures it has in place to mitigate the concern underlying the benchmark.

RG 227.22 Disclosure against the benchmarks should be:

- (a) addressed upfront in the PDS;
- (b) updated in ongoing disclosures as material changes occur (e.g. in a supplementary PDS); and
- (c) supported in, and not undermined by, advertising material.

In the interests of ensuring that existing investors are well informed, an issuer may also choose to provide regular reports on its benchmark information in other materials (e.g. monthly or quarterly updates), although providing updates in this form will not relieve the issuer from its disclosure requirements if any material changes occur.

RG 227.23 We believe that our approach balances:

- (a) the need to improve disclosure to allow investors to make better informed decisions; and
- (b) the desirability of avoiding undue interference with this market as a means for consumers to make investments.

Note: The need to strike an appropriate balance between protecting investors’ interests and allowing markets to operate freely is part of ASIC’s mandate under the *Australian Securities and Investments Commission Act 2001* (ASIC Act).



- RG 227.24 Our approach should not result in longer disclosures. Our experience indicates that investors need better quality and relevant disclosure, presented in a way best suited to investor understanding.

### **Applying the benchmarks to the issuer's business model**

- RG 227.25 Among issuers that provide OTC CFDs, there are two main pricing models that the industry and investors refer to (see REP 205, paragraph 52):
- (a) Under the market maker pricing model, the issuer offers CFDs at prices with reference to a range of pricing factors. Investors are expected to be price takers. As a market maker, client orders create a direct financial exposure for the issuer, which it may retain or hedge out. An issuer offering a market maker account can write CFDs against synthetic assets (such as indices) or real assets, even if there is little or no liquidity in the underlying market. As a result, it tends to offer a wider range of CFDs than other issuers.
  - (b) Under the direct market access (DMA) pricing model, the issuer automatically places a corresponding order directly into the underlying equity market and therefore does not carry any market risk from the trade. As a result, the issuer relies on there being volume in the underlying market in order for it to issue CFDs. Using programs that capture exchange data feeds, investors can actually see the matching orders placed by their DMA issuer into the underlying market.

An issuer may offer both kinds of accounts to investors or one only.

- RG 227.26 An issuer must meet the PDS content requirements to provide information about the significant characteristics and risks of the product: s1013D(1)(c) and 1013D(1)(f). This means it needs to ensure that its disclosure documents clearly explain the type of pricing model it operates for all offered accounts and highlight to potential investors any particular risks associated with that model. In disclosing against the specific benchmarks set out in this guide, an issuer should ensure that its explanation of how it is meeting the benchmarks addresses the particular characteristics and risks associated with the type of pricing model it operates.
- RG 227.27 One of the key PDS content requirements is to include information about the cost of the product: s1013D(1)(d). To the extent that a pricing model affects the way CFDs are priced, this should be clearly explained as part of effective fee disclosure. An issuer should explain whether its pricing of CFDs is derived by direct reference to the market price of the underlying asset, or whether it determines prices by reference to some other means. The issuer should explain the factors that will impact on any divergence of the prices it offers from those in the underlying market (e.g. volatility or illiquidity in the underlying market or the issuer's own profit margins and hedging costs). An

issuer that operates a market maker model will particularly need to explain how its prices are derived.

### Applying the benchmarks to counterparty risk

RG 227.28 A key area of risk associated with OTC CFDs is the counterparty risk borne by investors (i.e. the potential for the issuer to be unable to fulfil its obligations, resulting in loss for the investor). OTC CFD trades are not guaranteed by an exchange or clearing house, and investors therefore face the risk that the issuer may fail to meet some or all of its obligations (e.g. processing trades and returning profits made on trading).

RG 227.29 Investors must rely on the issuer to have in place appropriate arrangements to minimise the risk that it will not be able to meet its obligations. This means that an issuer needs to consider all the sources of risk to which it is exposed (e.g. market and operational risk, and the counterparty risk the issuer itself sustains when dealing with third parties, including other investors). These risks may be amplified by practices on the issuer's part, including:

- (a) inadequate hedging practices, including not hedging a sufficient proportion of the issuer's exposure to risk and hedging with counterparties that are not of strong financial standing;
 

Note: The term 'hedging' in this guide refers to the process where an issuer reduces a financial exposure (i.e. the issuer's contractual responsibility under a CFD entered into with investors) by entering into a corresponding transaction with another entity (a hedging counterparty) or on underlying markets.
- (b) holding insufficient capital to meet losses due to unhedged positions, or the default of hedging counterparties; and
- (c) poor client margining practices, leaving the issuer exposed to defaults by other clients.

RG 227.30 A number of the benchmarks are aimed at disclosing counterparty risk to investors.

## Advertising CFDs

RG 227.31 Advertising is an important mechanism for CFD issuers to recruit new investors, generate interest in CFD trading, and create awareness of the product.

Note: References to 'advertisements' in this guide should be read broadly. They include comment on and promotion of CFDs in media programs or publications (generally known as 'advertorials') and statements about CFDs published by an issuer on its website. They do not, however, include statements in a PDS.

- RG 227.32 Our research has indicated that retail investors who are thinking about investing place particular emphasis on the information and impressions given in advertisements. Indeed, given that most CFD issuers distribute directly to investors rather than through advisers, the information contained or implied in advertisements is often the first, and may be the only, information that investors use to decide whether or not to trade in CFDs and which issuer to use.
- RG 227.33 Our research identified some specific issues in the advertising of CFDs, including that many advertisements do not make adequate reference to the risks associated with CFDs. In general, we are concerned that the wording and presentation of CFD advertising is often liable to target a very broad audience, despite the fact that CFD trading is not likely to meet the investment objectives, needs and risk profile of many investors.
- RG 227.34 To promote investor understanding of CFDs and minimise the risk of advertising creating a misleading impression, an issuer should ensure that advertising is not inconsistent with any information provided in disclosure documents and that the advertising is targeted at an appropriate audience. This guide also notes certain statements that an issuer should include prominently in advertising to ensure that a balanced view is provided: see Section B.
- RG 227.35 A prominent warning should be included in advertising material, explaining that trading in CFDs involves the risk of losing substantially more than the initial investment, and that CFD investors do not own or have any rights to underlying assets (e.g. the right to receive dividend payments). If headline claims are not qualified by a sufficiently prominent warning, the advertisement can potentially create a misleading impression.

## Timeline for implementing improved disclosure

- RG 227.36 Table 2 outlines the key dates in implementing the proposed benchmark disclosure model.

**Table 2: Timeline for implementing improved disclosure**

<b>By 31 March 2012</b>	Existing issuers should address the benchmarks on an 'if not, why not' basis in updated disclosure, and bring it directly to the attention of existing investors.
<b>From 31 March 2012</b>	Existing issuers should refer to the benchmarks in new PDSs and ongoing disclosure on an 'if not, why' basis.  Issuers of new OTC CFDs should have PDSs and ongoing disclosure that discloses against the benchmarks on an 'if not, why not' basis.

**From 31 March 2012**

We will review updated investor disclosures to check that benchmarking information is adequately disclosed to investors on an 'if not, why not' basis.

We will also:

- work with issuers to ensure that the benchmarks and our disclosure expectations are understood;
- discuss any concerns we have about an issuer's disclosure with them and, where necessary, require additional disclosure (e.g. about the practical impact of not following a particular benchmark and the associated risks for investors); and
- conduct surveillance visits as needed to reinforce our disclosure expectations.

Note: See REP 205, paragraphs 21–29, for further details of our future work on OTC CFDs.

## B The disclosure benchmarks

### Key points

All issuers of OTC CFDs should address general benchmarks on:

- client qualification (see RG 227.37–RG 227.45);
- opening collateral (see RG 227.46–RG 227.50);
- counterparty risk—hedging (see RG 227.51–RG 227.58);
- counterparty risk—financial resources (see RG 227.59–RG 227.66);
- client money (see RG 227.67–RG 227.75);
- suspended or halted underlying assets (see RG 227.76–RG 227.80); and
- margin calls (see RG 227.81–RG 227.88).

### Benchmark 1: Client qualification

- RG 227.37 An issuer should maintain and apply a written client qualification policy that:
- (a) sets out the minimum qualification criteria that prospective investors will need to demonstrate they meet before the issuer will agree to open a new account on their behalf;
  - (b) outlines the processes the issuer has in place to ensure that prospective investors who do not meet the qualification criteria are not able to open an account and trade in CFDs; and
  - (c) requires the issuer to keep written records of client assessments.

#### Explanation

- RG 227.38 The complexity and risk inherent in OTC CFDs means that these types of products are unlikely to be appropriate for the investment objectives, needs and risk profile of many retail investors.
- RG 227.39 Many issuers do not provide investors with personal advice about whether OTC CFDs are appropriate for their objectives, financial situation and needs. Nevertheless, all issuers can play an important role in ensuring that only investors who have a sound understanding of the features and risks of the product can open an account and begin trading. Investors who thoroughly understand the features and risks of the product are better placed to determine whether it is an appropriate investment for them, and manage the risks associated with trading on an ongoing basis.

RG 227.40 An issuer should assess a prospective investor against qualifying criteria that address the investor's understanding of and experience with the product. For example, criteria should address the investor's:

- (a) previous experience in investing in financial products, including securities and derivatives;
- (b) understanding of the concepts of leverage, margins and volatility;
- (c) understanding of the nature of CFD trading, including that CFDs do not provide investors with interests or rights in the underlying asset over which a position is taken;
- (d) understanding of the processes and technologies used in trading; and
- (e) preparedness to monitor and manage the risks of trading.

An issuer may determine the best method of conducting the assessment itself. We consider that an online test, a face-to-face interview or a telephone interview would all be appropriate methods. In any case, an issuer should document the assessment process in writing, and retain this assessment.

RG 227.41 We do not consider that just making an assessment about a prospective investor's understanding of and experience with the product, including the criteria listed above, constitutes the provision of personal financial product advice.

Note: 'Personal advice' is defined in s766B(3) of the Corporations Act as financial product advice given or directed to a person (including by electronic means) in circumstances where:

- the provider of the advice has considered one or more of the person's objectives, financial situation and needs; or
- a reasonable person might expect the provider to have considered one or more of those matters.

RG 227.42 The issuer should also assist prospective investors by offering a practice account system, which allows investors to trade on a virtual basis for a period of time before proceeding to open an actual account, and mirrors the functions of actual accounts offered by the issuer. However, any practice systems or equipment offered to prospective investors should be offered on a non-obligatory basis.

### **PDS disclosure**

RG 227.43 If an issuer meets this benchmark, the PDS should clearly explain:

- (a) that trading in CFDs is not suitable for all investors because of the significant risks involved; and
- (b) how the issuer's client qualification policy operates in practice.

- RG 227.44 If an issuer does not have such a policy in place, or one that does not incorporate all of the elements described in RG 227.40, it should disclose this in the PDS and explain why this is so.

### **Advertising**

- RG 227.45 Any advertising of CFDs should be consistent with the issuer's client qualification policy—that is, it should not target an unreasonably broad audience, or provide the impression that CFD trading is likely to be suitable for an unlimited range of investors. Advertising that is not sufficiently targeted at a suitable audience risks creating an overall impression that CFDs are easy to use, which for many retail investors may not be the case.

## **Benchmark 2: Opening collateral**

- RG 227.46 An issuer should generally only accept cash or cash equivalents from investors as opening collateral when establishing an account to trade in CFDs. If credit cards are used to open accounts, an issuer should accept no more than \$1000 via credit card to fund the account.

### **Explanation**

- RG 227.47 Assets other than cash or cash equivalents as opening collateral (e.g. securities or real property) may expose investors to a greater risk of entering into financial difficulty, should they experience trading losses, than if they simply provided cash. Additionally, it is more likely that investors who are unable to provide cash when opening accounts will not hold sufficient funds to maintain margins on an ongoing basis.
- RG 227.48 We accept that credit card payments are commonly used in the industry as an instantaneous method of paying for accounts to be opened. However, placing a limit on the amount an issuer will accept from a credit card for this purpose ensures that investors only use a limited amount of borrowed funds to open accounts.

Note: This benchmark only applies to the methods of payment an issuer accepts for funding opening collateral when establishing an account to trade. It does not apply to ongoing payments made in association with trading (e.g. when meeting margin calls).

### **PDS disclosure**

- RG 227.49 If an issuer meets this benchmark, the PDS should explain the types of assets the issuer will accept as opening collateral.
- RG 227.50 If an issuer accepts non-cash assets as opening collateral (other than credit cards to a limit of \$1000), the PDS should explain why the issuer does so

and the additional risks that using other types of assets (e.g. securities and real property) as opening collateral may pose for the investor. This includes, for example, the risks of ‘double leverage’ if leveraged assets are accepted as opening collateral.

### Benchmark 3: Counterparty risk—Hedging

- RG 227.51 An issuer should maintain and apply a written policy to manage its exposure to market risk from client positions, which:
- (a) includes the factors it takes into account when determining if hedging counterparties are of sufficient financial standing; and
  - (b) sets out the names of those hedging counterparties (as they stand from time to time).
- RG 227.52 Policies should be displayed in an up-to-date form on the issuer’s website.

#### Explanation

- RG 227.53 As discussed in RG 227.28–RG 227.29, investing in OTC CFDs exposes investors to counterparty risk. Investors need to rely on the issuer taking appropriate measures to reduce the risk that it will not be able to meet liabilities. Such measures include having in place appropriate hedging strategies with counterparties that the issuer has assessed as being of strong financial standing.
- RG 227.54 An issuer should maintain and apply a written policy on hedging. The policy should provide sufficient explanation to allow investors to evaluate the quality of its hedging, including the types of factors the issuer takes into account when selecting counterparties (e.g. that counterparties have adequate financial and compliance resources), and should undertake that the issuer will provide the names of those counterparties in an accessible place (e.g. on the issuer’s website). The policy should not imply that the issuer’s hedging will eliminate counterparty risk to investors.
- RG 227.55 While it is important that this policy be made available to investors, we recognise that an issuer’s hedging arrangements and counterparties may change from time to time, and therefore it may not be practical for the issuer to provide a full explanation of its hedging policy in the PDS. Therefore, the issuer’s website is likely to be the more appropriate location to publish this document in full. The document should be maintained in an up-to-date form at all times.



## PDS disclosure

- RG 227.56 If an issuer meets this benchmark, the PDS should provide the following explanations:
- (a) a broad overview of the nature of hedging activity the issuer undertakes to mitigate its market risk, and the factors the issuer takes into account when selecting hedging counterparties; and
  - (b) details about where investors can find the issuer's more detailed policy on the activities it undertakes to mitigate its counterparty and market risk.
- RG 227.57 If an issuer does not meet this benchmark, it should disclose this in the PDS and explain why this is so.
- RG 227.58 The PDS must include information about the significant risks associated with the product: s1013D(1)(c). The PDS should also provide a clear explanation of the counterparty risk associated with OTC CFDs. The PDS should explain that, if the issuer defaults on its obligations, investors may become unsecured creditors in an administration or liquidation and will not have recourse to any underlying assets in the event of the issuer's insolvency.

## Benchmark 4: Counterparty risk—Financial resources

- RG 227.59 An issuer should maintain and apply a written policy to maintain adequate financial resources, which details how the issuer:
- (a) monitors its compliance with its Australian financial services (AFS) licence financial requirements; and
  - (b) conducts stress testing to ensure it holds sufficient liquid funds to withstand significant adverse market movements.

### Explanation

- RG 227.60 An AFS licensee must maintain adequate financial resources to provide the financial services covered by its licence and have in place adequate risk management systems: s912A(1)(d) and 912A(1)(h).
- RG 227.61 ASIC applies minimum financial requirements by AFS licence condition, depending on the nature of the financial services provided by the licensee. These requirements are described in Regulatory Guide 166 *Licensing: Financial requirements* (RG 166) and are imposed on licensees to ensure:
- (a) licensees have sufficient financial resources to conduct their financial services business in compliance with the Corporations Act (including carrying out supervisory arrangements);

- (b) there is a financial buffer that decreases the risk of a disorderly or non-compliant wind-up if the licensee's business fails; and
- (c) there are incentives for the licensee's owners to comply through risk of financial loss.

RG 227.62 An OTC CFD issuer operates in a particularly dynamic and volatile environment, with a high rate of cash turnover, and it needs to ensure it has access to sufficient liquid assets to meet all of its liabilities as and when they are due. An issuer that has insufficient financial resources in this regard risks not being able to meet its obligations to investors or needing to have recourse to client money to meet its obligations: see Benchmark 5, discussed in RG 227.67–RG 227.75. This in turn increases counterparty risk for investors.

RG 227.63 As part of meeting its obligations to maintain adequate financial resources, and to have in place adequate risk management systems, it is important that an issuer anticipate any expected or unexpected risks that may hinder its ability to meet its obligations to investors. We think a prudent business practice is to carry out regular (e.g. quarterly) stress testing, to ensure that, in the event of significant adverse market movements, the issuer would have sufficient liquid resources to meet its obligations to investors without needing to have recourse to client money to do so.

### **PDS disclosure**

RG 227.64 If an issuer meets this benchmark, the PDS should explain how the issuer's policy operates in practice.

RG 227.65 If an issuer does not meet the requirement on stress testing, it should explain why and what alternative strategies it has in place to ensure that, in the event of significant adverse market movements, the issuer would have sufficient liquid resources to meet its obligations to investors without needing to have recourse to client money to do so.

RG 227.66 The issuer should make a copy of its latest audited financial statements available to prospective investors free of charge, either on its website or upon request. The PDS should explain how investors can access the statements. In the case of a new issuer that is not yet required to prepare financial statements, the PDS should provide a summary of key financial data including paid-up capital, total assets, and total liabilities as of a date no more than 30 days prior to the date of the PDS. Such an issuer should also indicate in the PDS when it expects its audited financial statements to be available and how investors will be able to access those statements.

## Benchmark 5: Client money

RG 227.67 An issuer should maintain and apply a clear policy on its use of client money, including whether it uses money deposited by one investor to meet the margin or settlement requirements of another.

### Explanation

RG 227.68 The Corporations Act sets out various rules about how an AFS licensee must deal with money paid to it by its clients in connection with a financial service or product: s981A–981H.

Note 1: This guide refers to the rules contained in s981A–981H collectively as the ‘client money rules’.

Note 2: The client money rules do not apply to:

- (a) money paid as remuneration to an AFS licensee;
- (b) money paid to reimburse (or discharge a liability incurred by) the AFS licensee for payment made to acquire a financial product;
- (c) money paid to acquire a financial product from the AFS licensee;
- (d) loan money; or
- (e) money paid to be credited to a deposit product (s981A(2)).

RG 227.69 If the client money relates to derivatives, an AFS licensee is permitted to pool client money in one or more accounts and use this money to meet obligations incurred by the licensee in connection with margining, guaranteeing, securing, transferring, adjusting or settling dealings in derivatives by the licensee, including dealings on behalf of people other than the client: see s981D.

RG 227.70 This exposes investors to the risk that, if one client fails to pay money they owe (e.g. on a losing trade), the pooled client account could be in deficit. If the issuer does not cover this deficit, there may not be enough money in the account to pay the client what they are owed. If the issuer goes out of business while the pooled client account is in deficit, there is no guarantee that the client will receive all of their client money back: see Regulatory Guide 212 *Client money relating to dealing in OTC derivatives* (RG 212) at RG 212.14 for a more detailed discussion of the counterparty risks associated with the use of client money in relation to derivatives.

RG 227.71 An AFS licensee is also permitted to withdraw amounts from its client money account in certain circumstances, including to defray brokerage and other charges: see the Corporations Regulations 2001 (Corporations Regulations), reg 7.8.02. If an issuer withdraws a margin deposit from its client money account at the opening of a derivative position, the client is an unsecured creditor of the issuer for any payment that the licensee may be required to make on the close of the derivative position or as a consequence of ‘mark-to-market’ adjustments during the currency of the derivative. This

exposes clients to the risk that the issuer will not be able to perform these obligations: see RG 212.52–RG 212.64.

RG 227.72 In light of these risks, an issuer should develop a straightforward client money policy that includes a clear statement of how it will exercise any other permitted discretions in its use of client money—for example, in RG 212, we suggest this should include details of when an entitlement to margin deposits will be claimed: see RG 212.15.

### **PDS disclosure**

RG 227.73 If an issuer meets this benchmark, the PDS should clearly:

- (a) describe the issuer’s client money policy, including how the issuer deals with client money and when, and on what basis, it makes withdrawals from client money; and
- (b) explain the counterparty risk associated with the use of client money for derivatives.

RG 227.74 If an issuer does not have such a policy in place, or one that does not incorporate all of the elements described above, it should disclose this in the PDS. If an issuer’s policy allows it to use money deposited by one client to meet the margin or settlement requirements of another client, it should very clearly and prominently explain this and the additional risks to client money entailed by this practice.

RG 227.75 An issuer’s client money policy should be explained in the PDS in a way that allows potential investors to properly evaluate and quantify the nature of the risk, if any, to client money.

## **Benchmark 6: Suspended or halted underlying assets**

RG 227.76 An issuer should not allow new CFD positions to be opened when there is a trading halt over the underlying asset, or trading in the underlying asset has otherwise been suspended, in accordance with the rules of the relevant market.

Note: This benchmark does not apply to cases where trading has ceased in the ordinary course of events (e.g. when a market closes overnight).

### **Explanation**

RG 227.77 Opening positions in CFDs while there is a trading halt over the underlying asset, or trading in the underlying asset has otherwise been suspended, increases both the risk of investors trading without all the requisite information and the potential for insider trading.

## PDS disclosure

- RG 227.78 If an issuer meets this benchmark, the PDS should explain the issuer's approach to trading when underlying assets are suspended or halted.
- RG 227.79 If an issuer does not meet this benchmark, it should disclose this in the PDS and explain why this is so, as well as the additional risks that trading when underlying assets are suspended may pose for investors.
- RG 227.80 To provide a full explanation of this aspect of the product, an issuer should explain any discretions it retains as to how it manages positions over halted or suspended assets, and how it determines when and how it uses these discretions. This should include disclosure of any discretions the issuer retains to:
- (a) change the margin requirement on a position;
  - (b) re-price a position; or
  - (c) close out a position.

## Benchmark 7: Margin calls

- RG 227.81 An issuer should maintain and apply a written policy about its margining practices, which details:
- (a) how the issuer will monitor client accounts, to ensure that it receives early notice of accounts likely to enter into margin call;
  - (b) what rights the issuer may exercise in relation to client accounts, including the right to make a margin call or close out positions; and
  - (c) when the issuer will exercise these rights, and what factors it will take into account in deciding whether to do so.
- RG 227.82 Regardless of the issuer's other margining practices, the policy should require the issuer to take reasonable steps to notify investors before closing out positions. By 'reasonable steps' we mean giving notice to investors, according to a pre-agreed method (e.g. telephone message, email, SMS), that a position will shortly be closed out. If an issuer has a default method of communication, rather than agreeing this with each investor, this should be clearly explained in the PDS.

Note: We recognise that issuers will not necessarily be able to speak to investors and/or receive explicit consent before closing out positions.

## Explanation

- RG 227.83 The potential for CFD investors to enter into margin call is reasonably high because small movements in the price of the underlying asset may lead to large changes in the value of the CFD position.
- RG 227.84 Investors need to understand when the issuer is likely to make a margin call, and the action the issuer is likely to take should it do so. In particular, it is important that issuers take reasonable steps to notify investors when positions are to be closed out.
- RG 227.85 Additionally, maintaining robust margining practices is an important component of managing the issuer's exposure to risk from client positions because a resulting loss may also have follow-on consequences for other investors.

## PDS disclosure

- RG 227.86 If an issuer meets this benchmark, the PDS should explain the issuer's policy and margin call practices.
- RG 227.87 If an issuer does not have such a policy in place, or one that does not incorporate all of the elements described above, it should disclose this in the PDS and explain why this is so.
- RG 227.88 To provide full and accurate information about this aspect of CFD trading, the PDS should clearly state that trading in CFDs involves the risk of losing substantially more than the initial investment. This will ensure the issuer meets its obligation to include in the PDS information about the significant risks associated with the product: s1013D(1)(c).

## Summary of disclosure benchmarks

- RG 227.89 The benchmarks and their 'if not, why not' disclosure requirements are summarised in Table 3.

**Table 3: Disclosing against the benchmarks**

<b>1 Client qualification</b>	<p>If an issuer meets this benchmark, the PDS should clearly explain:</p> <ul style="list-style-type: none"> <li>• that trading in CFDs is not suitable for all investors because of the significant risks involved; and</li> <li>• how the issuer's client qualification policy operates in practice.</li> </ul> <p>If an issuer does not have such a policy in place, or one that does not incorporate all of the elements described in RG 227.40, it should disclose this in the PDS and explain why this is so.</p>
-------------------------------	---

<p><b>2 Opening collateral</b></p>	<p>If an issuer meets this benchmark, the PDS should explain the types of assets the issuer will accept as opening collateral.</p> <p>If an issuer accepts non-cash assets as opening collateral (other than credit cards to a limit of \$1000), the PDS should explain why the issuer does so and the additional risks that using other types of assets (e.g. securities and real property) as opening collateral may pose for the investor. This includes, for example, the risks of 'double leverage' if leveraged assets are accepted as opening collateral.</p>
<p><b>3 Counterparty risk— Hedging</b></p>	<p>If an issuer meets this benchmark, the PDS should provide the following explanations:</p> <ul style="list-style-type: none"> <li>• a broad overview of the nature of hedging activity the issuer undertakes to mitigate its market risk, and the factors the issuer takes into account when selecting hedging counterparties; and</li> <li>• details about where investors can find the issuer's more detailed policy on the activities it undertakes to mitigate its counterparty and market risk, and the names of any hedging counterparties.</li> </ul> <p>If an issuer does not meet this benchmark, it should disclose this in the PDS and explain why this is so.</p> <p>The PDS must include information about the significant risks associated with the product: s1013D(1)(c). The PDS should also provide a clear explanation of the counterparty risk associated with OTC CFDs. The PDS should explain that, if the issuer defaults on its obligations, investors may become unsecured creditors in an administration or liquidation and will not have recourse to any underlying assets in the event of the issuer's insolvency.</p>
<p><b>4 Counterparty risk— Financial resources</b></p>	<p>If an issuer meets this benchmark, the PDS should explain how the issuer's policy operates in practice.</p> <p>If an issuer does not meet the requirement on stress testing, it should explain why and what alternative strategies it has in place to ensure that, in the event of significant adverse market movements, the issuer would have sufficient liquid resources to meet its obligations to investors without needing to have recourse to client money to do so.</p> <p>An issuer should also make available to prospective investors a copy of its latest audited annual financial statement, either online or as an attachment to the PDS.</p>
<p><b>5 Client money</b></p>	<p>If an issuer meets this benchmark, the PDS should clearly:</p> <ul style="list-style-type: none"> <li>• describe the issuer's client money policy, including how the issuer deals with client money and when, and on what basis, it makes withdrawals from client money; and</li> <li>• explain the counterparty risk associated with the use of client money for derivatives.</li> </ul> <p>If an issuer does not have such a policy in place, or one that does not incorporate all of the elements described above, it should disclose this in the PDS. If an issuer's policy allows it to use money deposited by one client to meet the margin or settlement requirements of another client, it should very clearly and prominently explain this and the additional risks to client money entailed by this practice.</p> <p>An issuer's client money policy should be explained in the PDS in a way that allows potential investors to properly evaluate and quantify the nature of the risk, if any, to client money.</p>

<b>6 Suspended or halted underlying assets</b>	<p>If an issuer meets the benchmark, the PDS should explain the issuer's approach to trading when underlying assets are suspended or halted.</p> <p>If an issuer does not meet this benchmark, it should disclose this in the PDS and explain why this is so, as well as the additional risks that trading when underlying assets are suspended may pose for investors.</p> <p>To provide a full explanation of this aspect of the product, an issuer should explain any discretions it retains as to how it manages positions over halted or suspended assets, and how it determines when and how it uses these discretions. This should include disclosure of any discretions the issuer retains to:</p> <ul style="list-style-type: none"><li>• change the margin requirement on a position;</li><li>• re-price a position; or</li><li>• close out a position.</li></ul>
<b>7 Margin calls</b>	<p>If an issuer meets this benchmark, the PDS should explain the issuer's policy and margin call practices.</p> <p>If an issuer does not have such a policy in place, or one that does not incorporate all of the elements described above, it should disclose this in the PDS and explain why this is so.</p> <p>To provide full and accurate information about this aspect of CFD trading, the PDS should clearly state that trading in CFDs involves the risk of losing substantially more than the initial investment. This will ensure the issuer meets its obligation to include in the PDS information about the significant risks associated with the product: s1013D(1)(c).</p>



## C Implementing the disclosure benchmarks

### Key points

An issuer of OTC CFD products should use the benchmarks in Section B on an 'if not, why not' basis in meeting its disclosure obligations to investors: see RG 227.19–RG 227.24. We expect issuers to disclose against the benchmarks from 31 March 2012. We also expect issuers to provide existing investors with updated disclosure against the benchmarks by 31 March 2012: see RG 227.90–RG 227.91.

The benchmarks also reflect information that is material to the purposes of the issuer's obligations to provide ongoing disclosure to investors: see RG 227.102–RG 227.110.

We consider that an issuer should use a dedicated page on its website to provide regular updates to investors about material changes to the benchmark information: see RG 227.93–RG 227.94.

### Providing upfront and ongoing disclosure

RG 227.90 An issuer of both existing and new issues of OTC CFD products should disclose against the benchmarks: see Table 4. This is based on our view that the inherent risks for investors in OTC CFDs mean that information about these risks is required in both upfront and ongoing disclosures.

**Table 4: Implementing the disclosure benchmarks**

<b>Updating existing investors</b>	By 31 March 2012, an issuer should address the benchmarks on an 'if not, why not' basis in updated disclosure and bring it directly to the attention of existing investors: see RG 227.92–RG 227.94.
<b>Upfront disclosure for new investors</b>	All new PDSs issued on or after 31 March 2012 should disclose against the benchmarks on an 'if not, why not' basis: see RG 227.95–RG 227.101.  If there are material changes to the benchmark information while the PDS is current, the issuer will generally need to issue a new or supplementary PDS. The issuer should also communicate the information to existing investors who will not receive the PDS: RG 227.107–RG 227.108.
<b>Ongoing disclosures</b>	If there are material changes to the benchmark information, the issuer should deal with this in ongoing disclosures. We encourage issuers to communicate this information to investors as soon as practical.  In the interests of ensuring that existing investors are well informed, an issuer may also choose to provide regular updates on its disclosure against the benchmarks in other materials (e.g. monthly or quarterly updates). We recommend an issuer update investors at least every six months.  Note: We do not regard providing these updates as relieving an issuer of its other disclosure requirements.

- RG 227.91 We plan to review updated investor disclosures in this industry sector in the period from 31 March 2012 to check that this benchmarking information is adequately disclosed to investors on an ‘if not, why not’ basis.

## Updating existing investors

- RG 227.92 We expect issuers to provide existing investors with updated disclosure addressing each of the benchmarks in Section B on an ‘if not, why not’ basis by 31 March 2012.
- RG 227.93 We consider that an issuer should use a dedicated page on its website to provide regular updates to investors about material changes to the benchmark information. We think this is the easiest and most practical way to keep investors up-to-date.
- RG 227.94 If done well, website disclosure can be an important resource for investors. We think good website disclosure has the following features:
- (a) all material information is included on the website;
  - (b) an investor can find material information easily and determine its significance for them;
  - (c) any new material information is included on the website as soon as practicable; and
  - (d) information is kept on the website for as long as it is relevant and appropriate records are kept.

Note: Alternative or supplementary means of updating existing investors might be to produce a regular (e.g. quarterly) report and send it to investors, or to issue a supplementary PDS and send a copy to existing investors, or publish it on the website and notify investors that it is available and how to access it.

## Upfront disclosure for new investors

- RG 227.95 All new PDSs issued to retail investors on or after 31 March 2012 should disclose against the benchmarks in Section B on an ‘if not, why not’ basis. As described in RG 227.19–RG 227.20, this means that the PDS should state that the issuer either:
- (a) meets the benchmark (including how it meets the benchmark, where appropriate); or
  - (b) does not meet the benchmark and explain how and why the issuer deals with the business factor or issue underlying the benchmark in another way.
- RG 227.96 We expect the PDS to explain in a clear, concise and effective way:
- (a) the issuer’s pricing models; and

- (b) the nature of trading in CFDs (i.e. that taking a CFD position does not provide any interests or rights in the underlying assets, that a CFD is a leveraged product and the potential for entering into margin call is high).

### The role of upfront disclosure

- RG 227.97 The Corporations Act requires disclosure in the form of a PDS for an issue of OTC CFDs to retail investors. The PDS must:
- (a) make specific disclosures, including about the significant risks associated with holding the product (s1013D); and
  - (b) include all other information that might reasonably be expected to have a material influence on the decision of a reasonable person (when investing as a retail investor) about whether or not to invest in CFDs (s1013E).
- RG 227.98 Our benchmarks relate to matters that in any event must be disclosed under s1013D and s1013E. Issues relating to client qualification, opening collateral, counterparty risk, client money, hedging practices, the ability to trade when underlying assets are halted or suspended, and margin calls are all matters that might reasonably be expected to have a material influence on the decision of a retail investor about whether or not to invest in the product.
- RG 227.99 We expect an issuer to disclose against these benchmarks or explain why they do not. In addition, we consider that s1013D and s1013E require:
- (a) disclosure of these benchmarks and how they have been met;
  - (b) a statement that the issuer will continue to meet these benchmarks and if not, why not; and
  - (c) in circumstances where the issuer does not meet these benchmarks, disclosure of the extent to which they are not met and the reason they are not met. In some circumstances, not meeting these benchmarks is a risk that should be disclosed prominently.
- Note: A PDS should disclose against the benchmarks in Section B prominently and in one place (e.g. in the first few pages of the PDS either by a separate section or a clear and well-referenced table).
- RG 227.100 We will consider exercising our stop-order powers under s1020E if we think there is material non-disclosure or misleading disclosure. We believe that disclosure against these benchmarks upfront in a PDS promotes compliance with the requirement that PDSs should be worded in a clear, concise and effective manner. It encourages comparability and uniformity of financial measures, and highlights issues that ASIC and industry experts consider crucial to making an investment decision.

- RG 227.101 Experience suggests that clear, concise and effective PDS disclosure requires simple and straightforward disclosure of the issuer's business model. The issuer should use consumer-friendly tools as much as possible in disclosing key features and risks, including tables, diagrams and other comparative features.

## Ongoing disclosures

### Effective ongoing disclosure

- RG 227.102 If there have been any material changes to the benchmark information, including information about the issuer's alternative approach to meeting the benchmarks, the issuer should explain these in ongoing disclosures.
- RG 227.103 In a PDS, an issuer makes a number of statements about the benefits of investment in its product. These statements are part of the basis on which the investor invests their money, and the investor should be given the opportunity to monitor the issuer's performance against those statements.
- RG 227.104 Good ongoing disclosure, therefore, plays an important role in helping investors monitor their investment and evaluate its performance and decide if and when to increase or exit their investment (provided exit mechanisms exist).
- RG 227.105 An issuer has a number of obligations to make ongoing disclosures to investors under the Corporations Act: see RG 227.106. Apart from these legal requirements, we encourage issuers to use the most efficient and effective methods to regularly communicate key information to investors. As discussed in RG 227.93–RG 227.94, we think the most effective way of doing this is via a dedicated page on the issuer's website that is regularly used to update investors.

Note: On occasion, more formal communication (such as a supplementary PDS or s1017B notice) may be required in addition to these other methods of communication: see RG 227.106.

### Legal framework for ongoing disclosure

- RG 227.106 An issuer of CFDs has obligations to provide ongoing disclosure to investors under the Corporations Act, including:
- (a) issuing a supplementary PDS if there are certain material changes to information in a current PDS; and
  - (b) disclosure of material changes and significant events (s1017B).

## Supplementary PDSs

RG 227.107 The benchmarks relate to information required in a PDS under the Corporations Act. A PDS must be given to prospective investors in various circumstances: s1012A–1012C. The information in a PDS must be up-to-date at the time it is given: s1012J. If there are material changes to the benchmark information provided by the issuer, a new or supplementary PDS may need to be released.

Note: Class Order [CO 03/237] *Updated information in product disclosure statements* provides an exemption for updated information that is not materially adverse and which is made available.

RG 227.108 We consider that it is best practice to also make the information in a new or supplementary PDS available to existing investors (e.g. in a regular investor update or on the issuer's website).

## Notification of material changes and significant events

RG 227.109 An issuer must give investors notice under s1017B of any material change to a matter, or a significant event that affects a matter, that would have been required to be specified in a PDS.

RG 227.110 In our view, ceasing to meet a benchmark is a material issue that should be covered in notifications to investors under s1017B. When such changes or events are adverse to investors, notifications generally need to be provided as soon as practical and, in any event, within three months.

Note: If the change is an increase to fees and costs, under s1017B an issuer must provide product holders with at least 30 days notice before any increase.

## Appendix: Questions a potential investor should ask a CFD provider

These questions have been reproduced from ASIC's investor guide, *Thinking of trading contracts for difference (CFDs)?* We suggest a potential investor should ask a CFD provider these questions, or look for the answers in the PDS.

- What is the financial position of the CFD provider?
- What is the CFD provider's policy on the use of client money?
- How does the CFD provider determine the prices of CFDs they offer?
- Can the CFD provider change or re-quote the price after you have already placed your order?
- When processing CFD trades, does the CFD provider enter into a corresponding position in the market for the underlying asset?
- If there is little or no trading going on in the underlying market for an asset, can you still trade CFDs over that asset?
- Does the CFD provider let you trade CFDs even if the underlying market is closed?

For a copy of the investor guide, see ASIC's MoneySmart website at [www.moneysmart.gov.au/investing/complex-investments/contracts-for-difference](http://www.moneysmart.gov.au/investing/complex-investments/contracts-for-difference).

## Key terms

Term	Meaning in this document
AFS licence	An Australian financial services licence under s913B of the Corporations Act that authorises a person who carries out a financial services business to provide financial services <p>Note: This is a definition contained in s761A of the Corporations Act.</p>
AFS licensee	A person who holds an Australian financial services licence under s913B of the Corporations Act <p>Note: This is a definition contained in s761A of the Corporations Act.</p>
ASIC	Australian Securities and Investments Commission
ASIC Act	<i>Australian Securities and Investments Commission Act 2001</i> , including regulations made for the purposes of that Act
ASX	ASX Limited (ACN 008 624 691) or the exchange market operated by ASX Limited
client money rules	Collectively, the rules contained in s981A–981H of the Corporations Act
[CO 03/237] (for example)	An ASIC class order (in this example numbered 03/237)
contract for difference (CFD)	Includes references to margin forex and CFD or margin forex-type products, such as margin commodity products: see RG 227.1–RG 227.2
Corporations Act	<i>Corporations Act 2001</i> , including regulations made for the purposes of that Act
Corporations Regulations	Corporations Regulations 2001
derivative	Has the meaning given in s761D of the Corporations Act
DMA	Direct market access <p>Note: See RG 227.25(b) for further details.</p>
exchange-traded CFDs	CFDs traded on an exchange; in Australia, through the ASX

Term	Meaning in this document
financial product	<p>Generally, a facility through which, or through the acquisition of which, a person does one or more of the following:</p> <ul style="list-style-type: none"> <li>• makes a financial investment (see s763B);</li> <li>• manages financial risk (see s763C);</li> <li>• makes non-cash payments (see s763D)</li> </ul> <p>Note: See Div 3 of Pt 7.1 of the Corporations Act for the exact definition.</p>
financial service	Has the meaning given in Div 4 of Pt 7.1 of the Corporations Act
OTC CFD	A CFD traded as an OTC product, and not on an exchange
over-the-counter (OTC) product	A product traded directly between two parties, and not via an exchange
personal advice	<p>Financial product advice given or directed to a person (including by electronic means) in circumstances where:</p> <ul style="list-style-type: none"> <li>• the provider of the advice has considered one or more of the person's objectives, financial situation and needs; or</li> <li>• a reasonable person might expect the provider to have considered one or more of those matters</li> </ul> <p>Note: This is a definition contained in s766B(3) of the Corporations Act.</p>
Product Disclosure Statement (PDS)	<p>A document that must be given to a retail client in relation to the offer or issue of a financial product in accordance with Div 2 of Pt 7.9 of the Corporations Act</p> <p>Note: See s761A for the exact definition.</p>
reg 7.8.02 (for example)	A regulation in the Corporations Regulations (in this example, numbered 7.8.02)
REP 205 (for example)	An ASIC report (in this example, numbered 205)
retail client	A client as defined in s761G of the Corporations Act and Ch 7, Pt 7.1, Div 2 of the Corporations Regulations
retail investor	A retail client who trades in CFDs
RG 69	An ASIC regulatory guide (in this example, numbered 69)
s1017B (for example)	A section of the Corporations Act (in this example, numbered 1017B)



## Related information

### Headnotes

benchmark disclosure, client money, collateral, counterparty risk, hedging, leveraged derivative product, liquidity, margin call, OTC CFDs, over-the-counter contracts for difference, PDS, Product Disclosure Statement, risk, underlying asset

### Class order

[CO 03/237] *Updated information in product disclosure statements*

### Regulatory guides

RG 45 *Mortgage schemes: Improving disclosure for retail investors*

RG 46 *Unlisted property schemes: Improving disclosure for retail investors*

RG 69 *Debentures and unsecured notes: Improving disclosure for retail investors*

RG 166 *Licensing: Financial requirements*

RG 212 *Client money relating to dealing in OTC derivatives*

### Legislation

ASIC Act

Corporations Act, Div 2 of Pt 7.1, s761D, 761G and 761GA, Div 4 of Pt 7.1, s766B, Div 3 of Pt 7.6, s912, Div 2 of Pt 7.8, s981A–981H, Div 2 of Pt 7.9, s1012A–1012D, 1012J, 1013D and 1013E, Div 3 of Pt 7.9, s1017B, Div 7 of Pt 7.9, s1020E

Corporations Regulations, Sch 10, reg 7.8.02

### Report

REP 205 *Contracts for difference and retail investors*

### Investor guide

*Thinking of trading contracts for difference (CFDs)?*