



**ASIC**  
Australian Securities &  
Investments Commission

CONSULTATION PAPER 322

# Product intervention: OTC binary options and CFDs

August 2019

## About this paper

This paper sets out ASIC's proposals to exercise its product intervention power in Pt 7.9A of the Corporations Act to make certain market-wide product intervention orders relating to the issue and distribution of over-the-counter (OTC) binary options and contracts for difference (CFDs) to retail clients.

We are seeking the views of consumers, product issuers and other interested stakeholders on our proposed orders.

Note: The draft market-wide product intervention orders are on our website under [CP 322](#).

### 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 paper was issued on 22 August 2019 and is based on the Corporations Act as at the date of issue.

### Disclaimer

The proposals, explanations and examples in this paper do not constitute legal advice. They are also at a preliminary stage only. Our conclusions and views may change as a result of the comments we receive or as other circumstances change.

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## The consultation process

Before making a product intervention order, we must consult persons who are reasonably likely to be affected by the order: see s1023F of the *Corporations Act 2001* (Corporations Act).

You are invited to comment on the proposed product intervention orders in this paper.

We are keen to fully understand and assess the financial and other impacts of our proposed product intervention orders. Therefore, we ask you to comment on:

- our identification of the products and their availability for acquisition by issue to retail clients;
- the significant consumer detriment we have identified;
- the product intervention orders we propose to make;
- the likely compliance costs;
- the likely effect on competition;
- other impacts, costs and benefits; and
- the proposed delayed commencement of each order.

Where possible, we are seeking both quantitative and qualitative information.

Any information about compliance costs, effects on competition and other impacts, costs and benefits will be taken into account if we prepare a Regulation Impact Statement: see Section G, 'Regulatory and financial impact'.

### Making a submission

You may choose to remain anonymous or use an alias when making a submission. However, if you do remain anonymous we will not be able to contact you to discuss your submission should we need to.

Please note we will not treat your submission as confidential unless you specifically request that we treat the whole or part of it (such as any personal or financial information) as confidential.

Please refer to our [privacy policy](#) for more information about how we handle personal information, your rights to seek access to and correct personal information, and your right to complain about breaches of privacy by ASIC.

Comments should be sent by 1 October 2019 to:

OTC Intermediary Compliance  
Market Supervision  
Australian Securities and Investments Commission  
Level 7, 120 Collins Street, Melbourne, VIC 3000  
email: [Market.Supervision.OTC@asic.gov.au](mailto:Market.Supervision.OTC@asic.gov.au)

## What will happen next?

<b>Stage 1</b>	22 August 2019	ASIC consultation paper released
<b>Stage 2</b>	1 October 2019	Comments due on the consultation paper
<b>Stage 3</b>	From October 2019	<p>Consider all comments on the consultation paper.</p> <p>Consult the Office of Best Practice Regulation about our analysis of the regulatory impact of our proposals.</p> <p>Decide whether to make product intervention orders in respect of binary options and/or CFDs.</p> <p>Publish on our website notice of any decision to make a product intervention order and the terms of any product intervention order made, including the commencement date.</p>

## A Overview

### Key points

The Australian retail OTC derivatives sector is growing at a rapid pace.

We consider that OTC binary options and CFDs have resulted in, and are likely in future to result in, significant detriment to retail clients.

To address this harm, in this paper we propose to make market-wide product intervention orders relating to the issue and distribution of OTC binary options and CFDs.

Our proposals are consistent with product intervention measures in other jurisdictions.

### Our proposed product intervention

- 1 This paper highlights our concerns that the issue of OTC binary options and CFDs to retail clients in Australia has resulted in, and is likely in future to result in, significant detriment, including significant financial losses.
 

Note: In this paper, 'retail client' has the same meaning as defined in s761A of the Corporations Act.
- 2 Under Pt 7.9A of the Corporations Act, ASIC may make a product intervention order when we are satisfied that a financial product available for issue to retail clients has resulted in, or will or is likely to result in, significant detriment to retail clients.
- 3 On 26 June 2019, we published [Consultation Paper 313](#) *Product intervention power* (CP 313). CP 313 seeks feedback on a draft regulatory guide which sets out the scope of the product intervention power, when and how we expect to use the power and how a product intervention order is made. The feedback from that consultation process will inform this consultation process.
- 4 In this paper we propose to exercise our power to make market-wide product intervention orders in relation to OTC binary options and CFDs.

### Binary options and CFDs in Australia

- 5 Binary options are OTC derivatives that allow clients to make 'all-or-nothing' bets on the occurrence or non-occurrence of a specified event in a defined timeframe (e.g. the price of gold increasing in 30 seconds).

- 6 CFDs are leveraged OTC derivatives that allow clients to speculate on the change in the value of an underlying asset.
- 7 ASIC supervises AFS licensees who issue and make a market for binary options and CFDs in or from Australia to retail clients. These products are marketed by issuers to retail clients, primarily through online marketing and the use of trading inducements. Issuers also commonly engage third parties to promote their products to retail clients, but licensed financial advice is uncommon.
- 8 The Australian market for binary options and CFDs continues to experience significant growth. Complaints about binary options and CFDs have also increased sharply.

## Significant detriment to retail clients from binary options and CFDs

- 9 We consider that binary options and CFDs have resulted in, and are likely in future to result in, significant detriment to retail clients, primarily financial losses. This is because:
- (a) for binary options:
    - (i) most retail clients who trade binary options lose money;
    - (ii) there is a negative expected return, resulting in significant market-wide financial losses;
    - (iii) there is a high likelihood of cumulative losses; and
    - (iv) the inherent structural design flaws are confusing and make them unsuitable as an investment or risk management product for retail clients—we find their characteristics are akin to gambling.
  - (b) for CFDs:
    - (i) most retail clients who trade CFDs lose money;
    - (ii) high leverage ratios carry inherent risk of significant losses, including losses which can exceed a retail client's initial investment;
    - (iii) fees and costs lack transparency, are magnified by leverage and can quickly and significantly deplete a retail client's investment; and
    - (iv) confusing and unclear pricing methodologies can lead to the sale to retail clients of CFDs that are misaligned with their needs, expectations and understanding.
- 10 For many years we have taken strong and frequent regulatory action, using a range of regulatory tools, to address our concerns about binary options and

CFDs: see Appendix 1. However, we consider retail clients continue to suffer significant detriment from these products.

## International measures in relation to binary options and CFDs

- 11 Our concerns about binary options and CFDs, and the significant detriment to retail clients resulting from these high-risk products, are not unique to the Australian market.
- 12 The International Organization of Securities Commissions (IOSCO) recently published a [toolkit](#) (PDF 988 KB) which is intended to be used by regulators to enhance protections for retail clients.
- 13 An increasing number of foreign regulators have implemented, or are planning to implement, measures to prohibit or restrict the offer of binary options and CFDs.
- 14 We will continue to closely monitor for 'regulatory arbitrage', and other potential avoidance practices by issuers which undermine or attempt to work around the intended purpose of our proposed intervention. If significant consumer detriment persists we will consider further intervention.

## Proposed product intervention: Binary options

- 15 We propose to make a market-wide product intervention order that prohibits the issue and distribution of OTC binary options to retail clients: see Section E and Attachment 1 (on our website under [CP 322](#)).
- 16 Binary options, in our view, provide no meaningful investment or economic utility. Unlike other types of OTC derivatives or exchange traded products, binary options do not offer participation in the growth in value of the underlying asset. The typical 'all-or-nothing' payoff structure of binary options also makes them unsuitable for risk management arrangements such as hedging.
- 17 The proposed product intervention order addresses our concerns about the inherent risks of binary options by removing the possibility for retail clients to trade them and to make losses.
- 18 Our proposed intervention is also consistent with measures taken in other jurisdictions.

## Proposed product intervention: CFDs

- 19 We propose to make a market-wide product intervention order that imposes certain conditions on the issue and distribution of OTC CFDs to retail clients: see Section F, Attachment 2 (on our website under [CP 322](#)) and Appendix 2.
- 20 Unlike binary options, CFDs can serve legitimate trading, investment and hedging purposes. However, it is concerning that most retail clients lose money trading CFDs, often due to excessive leverage. Unclear or confusing presentation of information to retail clients about the risks, pricing and costs of CFD trading can lead to the sale of CFDs that are misaligned with clients' needs, expectations and understanding.
- 21 The proposed product intervention order conditions relating to CFDs would:
- (a) impose CFD leverage ratio limits (Condition 1);
  - (b) implement a standardised approach to the automatic close-out of retail client positions (Condition 2);
  - (c) protect against negative balances (Condition 3);
  - (d) prohibit the offer of certain inducements in relation to CFDs (Condition 4); and
  - (e) require enhanced transparency of CFD pricing, execution, costs and risks (Conditions 5–8).
- 22 Condition 6 (real-time disclosure of total position size) and Condition 7 (real-time disclosure of overnight funding costs) address additional concerns we have identified in our surveillance activities. If implemented, it is our understanding that Australia will be the first jurisdiction to introduce product intervention measures of this nature.
- 23 Our proposed intervention is otherwise consistent with measures taken in other jurisdictions.

## Our next steps

- 24 This consultation paper should not be construed as an indication that we have made a final decision on exercising our product intervention power. A final decision will be made once we have considered the feedback to our proposals. Similarly, the terms of any final product intervention orders may change, depending on feedback and any further information we receive.
- 25 Our proposals in this paper apply to OTC binary options and CFDs. However, there are also other leveraged financial products—traded OTC or on an exchange—which are issued to retail clients and which exhibit similar characteristics or risks.

- 26            We continue to consider potential future market-wide product intervention orders which, for example, could impose certain conditions (such as leverage ratio limits) on a broader range of financial products offered to retail clients. Any future proposed orders would be subject to a separate consultation process.

## B Binary options and CFDs in Australia

### Key points

Binary options are OTC derivatives that allow clients to bet on the occurrence or non-occurrence of a specified event in a defined timeframe, such as an increase in the price of an underlying asset.

CFDs are leveraged OTC derivatives that allow clients to speculate on the change in the value of an underlying asset. 'Margin FX' is a popular CFD that references currency pairs.

Binary options and CFDs are available for acquisition by issue to retail clients in Australia.

ASIC supervises AFS licensees who issue and make a market for binary options and CFDs in or from Australia to retail clients.

Our analysis shows that the Australian market for these products continues to experience significant growth, particularly in client numbers, transaction volume and gross annual turnover.

### Binary options

- 27 Binary options are OTC derivatives that allow clients to bet on the occurrence or non-occurrence of a specified event in a defined timeframe. This can include a bet on movements in the price of a financial product, a market index or an economic event (such as central bank interest rate decisions).
- 28 'Over-the-counter' or 'OTC' means that the derivatives are transacted between two counterparties (being the issuer of the derivative and the client), not on an exchange. In Australia, binary options and CFDs are currently only traded OTC.
- 29 The term 'binary' illustrates the typical 'all-or-nothing' payout structure of binary options. If the bet made by the client in relation to the specified event is correct, the retail client 'wins' (i.e. the client receives a predetermined cash payout, less any fees and costs). If the bet on the event is not correct, the client 'loses' (i.e. the client loses their investment amount, plus any fees and costs).
- 30 For example, an 'up/down' binary option is a bet on whether the price of an underlying asset will go up or down over a specified period.

- 31 The predetermined cash payout for a ‘winning’ binary options contract is sometimes expressed as a dollar figure (e.g. \$180) or a profit as a percentage of the investment amount (e.g. 80% of the investment amount).
- 32 Binary options typically have a short-term contract duration. For example, some issuers offer binary options to retail clients with a contract duration of only 30 seconds.
- 33 The minimum investment amount to enter into a binary options contract can be minimal—as small as \$10. Binary options issuers may also charge additional fees and costs, such as commission costs.
- 34 Binary options are often marketed by issuers under different names or descriptions. Examples include ‘all-or-nothing options’, ‘fixed return options’, ‘digital options’ and ‘countdowns’. For the purposes of this paper and Proposal E1 our reference to ‘binary options’ is intended to capture all derivatives that fall within our proposed definition, however named or described.
- Note: See the definition of ‘binary option’ in our proposed product intervention order in Attachment 1 (on our website under [CP 322](#)).
- 35 There are five licensed issuers of binary options in Australia. We understand that some other AFS licensees have ceased offering binary options due to strong regulatory interventions in other jurisdictions: see Table 3.

## Contracts for difference

- 36 CFDs are leveraged OTC derivatives that allow clients to speculate on the change in the value of an underlying asset. This can include currency pairs (such as AUD/USD) which are also known as ‘margin foreign exchange’ or ‘margin FX’ and are the most commonly traded type of CFD in Australia. Other underlying assets include equity indices, single equities, commodities, crypto-assets (e.g. Bitcoin), interest rate instruments, futures and options.
- Note: Crypto-asset CFDs are relatively new but growing quickly in Australia. We have identified 35 issuers that offer crypto-asset CFDs in or from Australia to retail clients.
- 37 Clients can open a ‘long’ or ‘short’ CFD position. A long position means entering into a CFD contract with the expectation that the underlying asset will increase in value. A short position means entering into a CFD contract with the expectation that the underlying asset will decrease in value.
- 38 In both cases, when a client closes their CFD position, their profit or loss is the difference between the closing value and the opening value of their CFD position (including any fees and other costs such as interest charges on positions held overnight). Clients are effectively betting on whether the

value of the underlying asset is going to rise or fall in the future, compared to the value when the CFD contract is opened.

39 Unlike binary options, CFDs are typically leveraged. This enables clients to use a small initial investment (known as ‘margin’) to gain exposure to an asset for a proportion of that asset’s value. For example, for a CFD contract with a leverage ratio of 200:1, a client would only have to deposit an initial margin of \$5,000 to gain economic exposure of \$1 million to the performance of the underlying asset. The client is effectively in a similar position to borrowing the other 99.5% of the value of the underlying asset of the CFD.

40 A client does not own the underlying asset of a CFD. Instead, CFDs only give clients indirect exposure to the underlying asset of the CFD.

41 For the purposes of this paper and Proposal F1 our reference to ‘CFDs’ is intended to capture all derivatives that fall within our proposed definition.

Note: See the definition of ‘CFD’ in our proposed product intervention order in Attachment 2 (on our website under [CP 322](#)).

## Availability of binary options and CFDs to retail clients

### Our 2017 and 2019 reviews of the sector

42 In 2017 we conducted a review of the size and nature of the Australian market for binary options and CFDs (2017 review).

43 Our 2017 review was based on data collected from 57 AFS licensees that were actively issuing binary options or CFDs (or both) in or from Australia to retail clients. Issuers were asked to provide us with data for any 12-month period between 1 January 2016 and 30 June 2017.

44 In June 2018, we published [Report 579](#) *Improving practices in the retail OTC derivatives sector* (REP 579), which reported on the results of our 2017 review.

45 This year we undertook a subsequent analysis of the Australian retail OTC derivatives market (2019 review).

46 Our 2019 review was based on data collected from 61 AFS licensees that were actively issuing binary options or CFDs (or both) in or from Australia to retail clients. Issuers were asked to provide us with data for the period 1 January 2018 to 31 December 2018. In some instances, we asked issuers to provide us with data as at 31 March 2019 (e.g. number of clients).

## Retail OTC derivatives issuers and product distribution

47 ASIC is responsible for the regulation and supervision of AFS licensees who issue and make a market for binary options and CFDs in or from Australia to retail clients.

48 We have identified 65 AFS licensees, as at 1 August 2019, who issue binary options or CFDs in or from Australia to retail clients.

49 A common distribution practice which we have observed is the use by issuers of third parties (referrers) that refer potential new retail clients to the issuer. Referrers may include ‘authorised representatives’, ‘affiliates’, ‘introducing brokers’ or existing retail clients. In return, referrers commonly receive some form of remuneration from the issuer. We have heard from some retail client reports that referrers have approached them in chat rooms, dating sites, through mainstream social media and taxi cabs.

Note: We discuss referral arrangements in more detail in REP 579.

50 In our 2019 review we found that issuers had arrangements with over 60,000 referrers in aggregate. Of these, 92% of referral arrangements provide for remuneration based on client trading volumes. In 2018, issuers paid over \$281 million in remuneration to referrers.

## Growth in the Australian market

51 The size of the Australian market for binary options and CFDs has grown considerably over recent years through the increase in the number of clients and transactions, as well as gross annual turnover.

52 Figure 1 illustrates the growth in the sector between our 2017 and 2019 reviews. Of the 675 million transactions reported in our 2019 review, approximately 79% were in CFDs and the remaining 21% were in binary options. This compares to approximately 85% and 15% respectively in our 2017 review.

**Figure 1: Growth in the Australian market for binary options and CFDs between our 2017 and 2019 reviews**

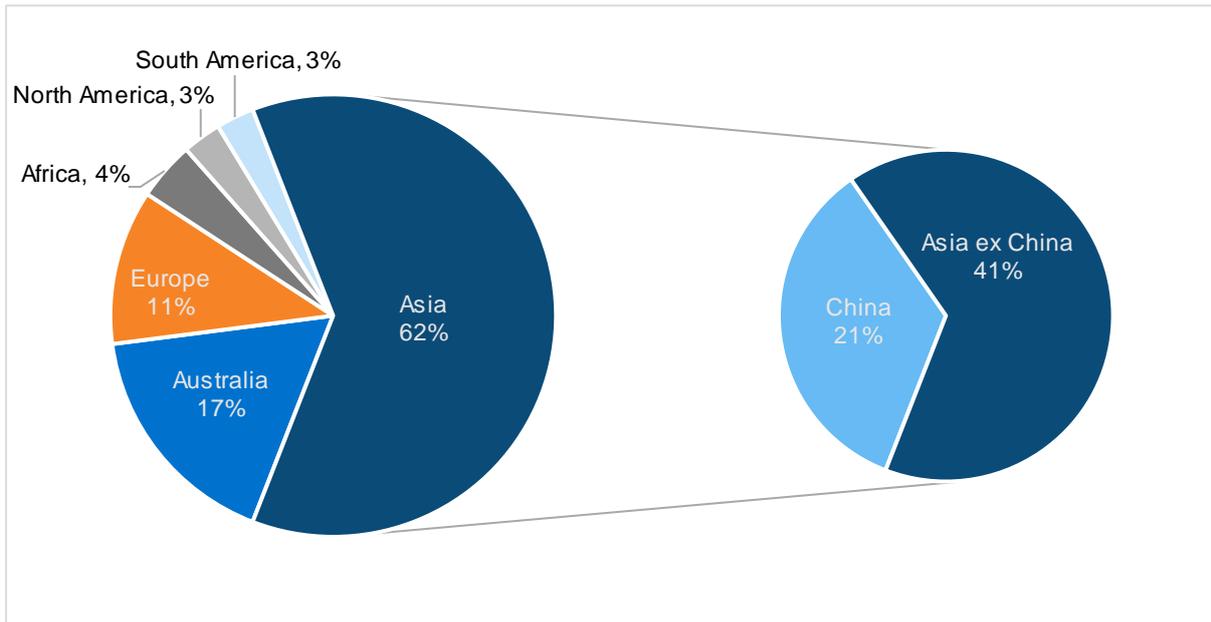


Note: Gross annual turnover is the total position value of all client trades in binary options and CFDs that are processed by AFS licensees. Client funds and number of transactions are for retail and wholesale clients.

### Client demographics

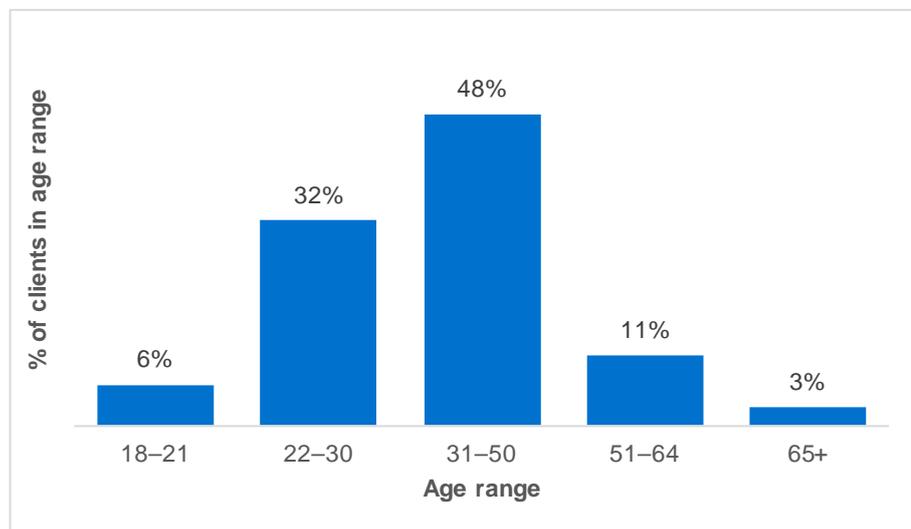
- 53 Data we gathered from issuers licensed in Australia shows that binary options and CFDs are generally marketed to, and traded by, retail clients.
- 54 As at 31 March 2019, 99% of binary options and CFD issuers' clients were retail clients.
- 55 Surprisingly, as at 31 March 2019, clients based in Australia accounted for just 17% of the approximately 1 million clients of binary options and CFD issuers identified in our 2019 review. The largest percentage of clients (62%) were based in Asia, one-third of which (21% of total clients) were based in China: see Figure 2.

**Figure 2: Distribution of binary options and CFD clients by jurisdiction**



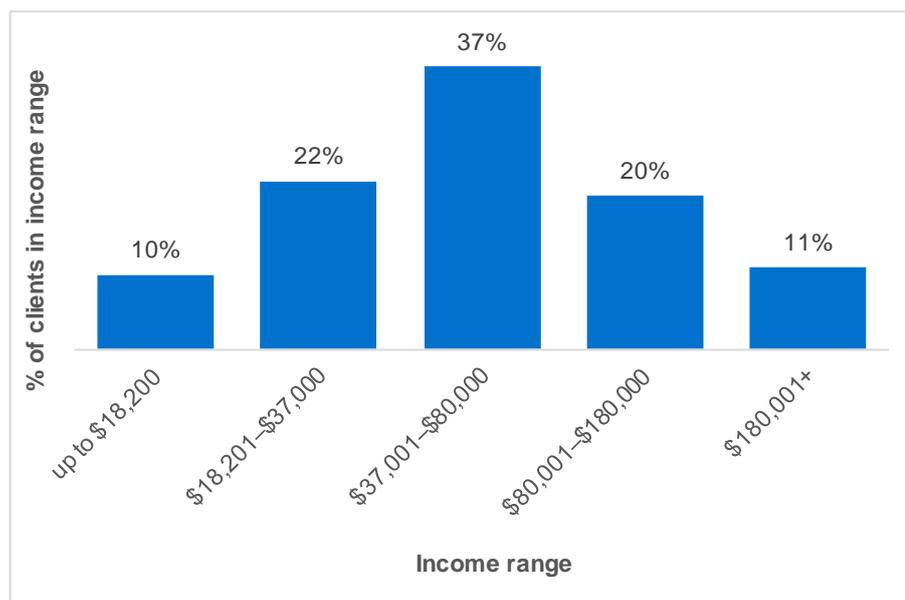
56 Figure 3 and Figure 4 show the age groups and income levels of clients of binary options and CFD issuers, reported to us in anonymised form in our 2019 review.

**Figure 3: Age groups of binary option and CFD clients by percentage (as at 31 March 2019)**



57 Figure 3 shows that 80% of clients were in the 22–50 years age group, with nearly half of all clients aged between 31 and 50 years as at 31 March 2019. Fourteen percent of clients were aged over 50.

**Figure 4: Income levels of binary options and CFD clients by percentage (as at 31 March 2019)**



58 Figure 4 shows that close to 70% of clients earn an annual income of \$80,000 or less, which is roughly the median full-time income in Australia. Notably, 32% of all clients had an annual income of \$37,000 or less.

### Marketing practices

59 Many retail clients do not seek or receive financial advice before deciding to trade binary options or CFDs, instead relying on advertising, social media and the internet for information.

60 In our 2019 review, binary options and CFD issuers reported that their aggregate annual marketing expenses increased by 40% from \$93 million in 2017 to \$131 million in 2018, while there was no material change in the number of issuers.

61 We have observed the aggressive marketing practices used by CFD issuers over many years. They are used to attract new clients as well as to entice existing clients to trade more. We have received reports from industry stakeholders that there is a significant turnover or ‘churn’ of retail clients, and some issuers are heavily reliant on aggressive marketing techniques to attract new retail clients.

62 Issuers reported that in 2017 and 2018 over 225,000 new clients were given inducements to open an account to trade binary options or CFDs.

### Examples of inducements

#### 'Free' gift

We have observed CFD issuers offering a 'free' gift (e.g. a tablet computer) on the condition that the client takes a certain number of CFD positions, which ultimately ends up costing more than the gift itself. This is particularly concerning given evidence which suggests the risk of losing is amplified with more frequent trading.

#### Bonus credits

We have seen instances of bonus credits being offered to existing clients who have received a margin call and need to deposit more funds to keep their CFD position open. The CFD issuer may offer to match their additional deposit with a 'bonus credit' (e.g. 50% or 100% of deposited funds) to increase the client's margin and keep their position open. While the bonus credits are available to the client for trading, they typically cannot be withdrawn from the account as equity until predetermined conditions are met (e.g. the aggregate value of trading on the client's account in the month after the bonus credit was granted exceeds 5,000 times the amount of the bonus credit).

#### Spread rebates

Spread rebates are another inducement used to encourage CFD clients to trade more. These are rebates of a percentage of spread fees paid by the client over a month and are offered on the condition the client makes a further deposit. For example, we received a report that a CFD issuer offered a client a rebate of \$15,000 (being a percentage of that client's spread payments for the month) provided the client made a further \$60,000 deposit into their account. This spread rebate was offered despite the client clearly indicating they were suffering financial distress.

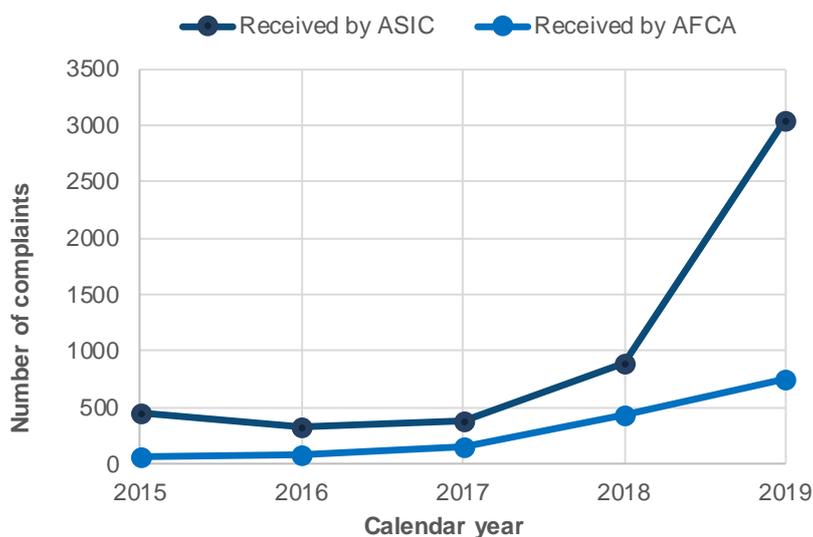
- 63 Aggressive marketing and the offer of inducements can attract financially vulnerable consumers and can exploit a range of behavioural factors leading many consumers to underestimate the high risks of these products. As Figure 3 and Figure 4 depict, around 32% of clients trading binary options and CFDs had an annual income of \$37,000 or less and over 14% of the clients were over 50 years of age. Trading losses could lead to hardship for low income earners and those approaching retirement as these groups may find it difficult to replenish their savings. Indeed, this is what we are seeing from some reports by retail clients.

### Complaints about binary options and CFDs

- 64 Complaints about binary options and CFDs account for over one-third of the markets-related complaints we have so far received in 2019. This is a disproportionately large number when our regulated population in the financial markets sector is over 3,500 entities, including listed entities, market participants, licensed securities dealers and investment banks.

65 The number of complaints about binary options and CFDs has accelerated since 2017. We have identified just under 4,000 complaints reported to either ASIC or the Australian Financial Complaints Authority (AFCA) in the first seven months of 2019: see Figure 5.

**Figure 5: Number of complaints to ASIC and AFCA about retail OTC derivatives (2015–2019)**



Note: See Table 8 for the data shown in this figure (accessible version).

66 Some themes from the complaints include:

- (a) clients experiencing unexpected, large losses and, in some cases, owing a debt to the issuer—it is clear from these cases that many retail clients do not understand the risks of the products;
- (b) concern that prices had not been determined fairly (e.g. advantageous to an issuer's position but unfair to the retail client's, or the issuer adjusting quotes to trigger stop-losses), which contributes to retail client losses;
- (c) claims of unfair discretion exerted by the issuer when automatically closing out client positions;
- (d) the use of high-pressure sales strategies by issuers, including pressuring clients to access other sources of funds (e.g. credit card facilities, home-loan equity, superannuation); and
- (e) clients not able to withdraw their funds.

## C Significant detriment to retail clients from binary options and CFDs

### Key points

We consider that binary options and CFDs issued to retail clients have resulted in, and are likely in future to result in, significant detriment to retail clients, primarily financial losses.

We have taken strong regulatory action to address our concerns about binary options and CFDs, using a range of our regulatory tools. However, retail clients continue to suffer significant detriment from these products.

### Significant detriment to retail clients from binary options

67 We consider binary options have resulted in, and are likely in future to result in, significant detriment to retail clients because:

- (a) most retail clients who trade binary options lose money;
- (b) binary options have a negative expected return, resulting in significant market-wide financial losses;
- (c) there is a high likelihood of cumulative losses trading binary options; and
- (d) the inherent structural design flaws of binary options are confusing and make them unsuitable as an investment or risk management product for retail clients—we find the characteristics of binary options are akin to gambling.

#### Most retail clients who trade binary options lose money

68 Binary options issuers reported in our 2017 review that, of their 72,716 binary options clients, around 80% lost money trading binary options.

69 Such losses may adversely affect retail clients' confident participation in Australian financial markets.

70 During the calendar year 2018, issuers of binary options and CFDs received gross trading revenue of \$2 billion (2019 review) of which \$490 million was from binary options and \$1.5 billion from CFDs. These figures can largely be attributed to a combination of net client trading losses and spreads, fees and commissions charged to clients. On this basis, we estimate that retail client losses from trading binary options were at least \$490 million in 2018.

- 71 Our findings in relation to client losses are broadly consistent with reported losses in other jurisdictions. For example:
- (a) the UK Financial Conduct Authority (FCA) found that:
    - (i) in 2016, between 81% and 85% of client accounts lost money and, on average, clients made a loss of between £400 and £1,200;
    - (ii) many of these clients appeared to make a profit from trading but made a loss when taking into account the impact of transaction fees; and
    - (iii) retail clients collectively experienced an average estimated loss of around £17 million in 2018 when trading binary options (before the products were banned);
  - (b) the Cyprus Securities and Exchange Commission (CySEC) found that from 1 January 2017 to 31 August 2017, on average, 87% of client accounts made a loss of around €480;
  - (c) the Polish Komisja Nadzoru Finansowego (KNF) found that in 2016 86.3% of clients lost money trading binary options and in 2017 86.4% lost money; and
  - (d) the Italian Commissione Nazionale per le Società e la Borsa (CONSOB) found that in 2016 up to 74% of Italian retail clients made losses, with an average loss of approximately €590.

Note: See FCA [CP18/37](#) *Product intervention measures for retail binary options* (PDF 487 KB), at p.21, issued in December 2018 and [Central Bank of Ireland Binary Options Intervention Measure](#) (PDF 332 KB) in effect from 2 July 2019, at pp.11–12.

### **Negative expected returns result in significant market-wide financial losses**

- 72 Due to their typical ‘all-or-nothing’ payoff structure and short-term contract duration, binary options are highly speculative products. For each binary options contract, one of the two possible outcomes is that the retail client will lose their entire investment amount.
- 73 Generally, the ‘expected return’ of an investment is the amount of profit or loss a retail client can anticipate receiving on that investment. When trading binary options, the retail client faces a negative expected return. This is because the present value of the expected payoff for a binary options contract is lower than the initial investment: see the example below.

**Example of negative expected return**

An 'up/down' binary option, based on the level of large stock Index ABC, is issued with a contract duration of 10 minutes. The investment amount is \$100 and the predetermined payout is \$180 (i.e. the initial \$100 + \$80).

If after 10 minutes the price of Index ABC is higher, the client receives a payout of \$180 (less any fees or costs), which includes a net profit of \$80.

If the price of Index ABC is lower, the client loses their \$100 initial investment plus any fees and costs.

The probability of any return is around 50% because the market is typically efficient and random during very short time horizons. With a 50% probability of Index ABC being higher after 10 minutes, the expected value of the binary option is half of \$180 (i.e. \$90) which is 10% less than the initial investment. The expected return of this binary option is therefore negative.

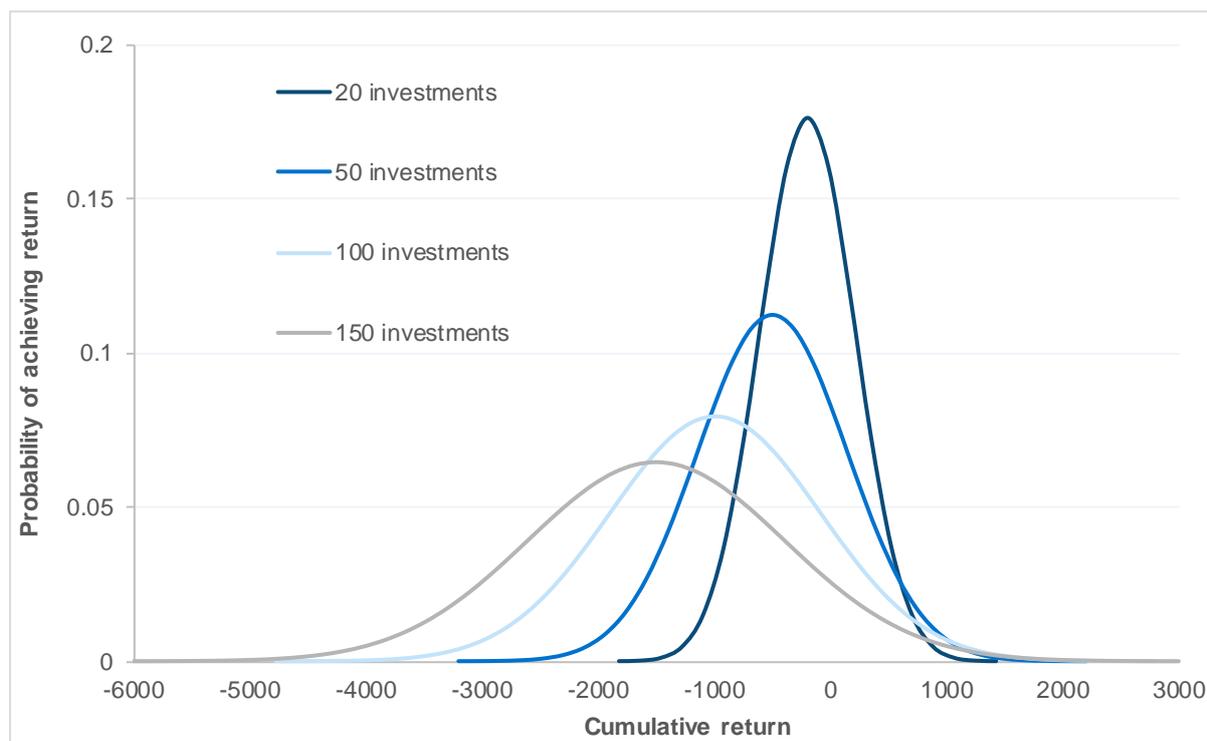
- 74 Although at an individual retail client level a one-off binary options contract may result in a relatively small loss (due to typically small minimum investment amounts required by binary options issuers), we consider that the negative expected return for binary options contracts means that, at a market-wide level, aggregate losses for all retail clients are significant. We have found that most clients that trade binary options lose money: see paragraph 68.

**High likelihood of cumulative losses**

- 75 Figure 6 shows that as a retail client trades more binary options contracts over time, there is a greater probability of suffering a loss on a cumulative basis.
- 76 Figure 6 replicates a simulation run by the European Securities and Markets Authority (ESMA) as part of its quantitative analysis of the return distribution for retail clients in binary options. This simulation is equally applicable to binary options offered in Australia.
- 77 It illustrates the distribution of aggregate returns from different scenarios of repeated \$100 trades in a binary options contract with a fixed 180% payout—that is, the retail client receives \$80 if they win and loses their \$100 if they lose—and an equal chance of winning or losing.
- 78 The likelihood of specific outcomes from the different scenarios can be inferred from the chart. The proportional area under the curve which lies to the left of zero indicates the likelihood of losing money overall, while peaks represent the most likely outcomes.
- 79 The shift of the return distributions to the left as the number of trades increases indicates that the more binary options trades made, the greater the likelihood that the retail client will lose money overall, and the larger the expected loss.

80 For example, when 20 trades are made, the probability of a cumulative loss is approximately 75%, with the most likely outcome being a loss of \$200. When 150 trades are made, the probability of loss is roughly 92% and the most likely outcome is a loss of \$1,500.

**Figure 6: Distribution of aggregate returns from selected numbers of repeated binary options trades**



Source: Based on analysis by ESMA, [Product intervention analysis: measure on binary options](#) (PDF 776 KB), 1 June 2018, ESMA50-162-214.

Note: This graph is explained in paragraphs 75–130 (accessible version).

81 Our analysis of trades in binary options in Australia in 2018 supports this simulation and shows that the percentage of clients that lose increases the more they trade.

### **Not suitable as an investment product**

82 Binary options are unsuitable to be offered as investment products to retail clients. This is because of the negative expected return embedded within their payoff structure, the lack of transparency in their pricing and the absence of any meaningful economic or investment utility to the retail client.

83 There is typically less transparency for binary options compared to other OTC derivatives, in terms of pricing, strike price determination and payout structures: see REP 579. This lack of transparency is one reason why retail clients may be unaware of the negative expected return when trading binary options. Further, we have found that disclosure alone is ineffective in helping retail clients to understand these risks because humans' ability to

accurately assess abstract matters such as risk and probability is innately constrained, and these products are highly complex.

- 84 None of the risks inherent in trading binary options are offset by any compensatory benefits such as investment or risk management utility. Unlike other types of OTC derivatives or exchange traded products, binary options do not offer participation in the growth in value of the underlying asset. Also, the ‘all-or-nothing’ payoff structure of binary options makes them unsuitable for risk management arrangements such as hedging. By comparison, OTC CFDs can serve legitimate trading, investment and risk management purposes: see paragraph 86.

## Significant detriment to retail clients from CFDs

- 85 We consider CFDs have resulted in, and are likely in future to result in, significant detriment to retail clients because:
- (a) most retail clients who trade CFDs lose money;
  - (b) trading CFDs has an inherent risk of significant losses due to the product’s high leverage ratios, including losses which can exceed a retail client’s initial investment;
  - (c) fees and costs lack transparency, are magnified by leverage and can quickly and significantly deplete a retail client’s investment; and
  - (d) confusing and unclear pricing methodologies can lead to the sale to retail clients of CFDs that are misaligned with their needs, expectations and understanding.
- 86 Unlike binary options, we consider that CFDs can serve legitimate trading, investment and risk management purposes where appropriate protections are in place for retail clients. For example, a client who holds shares in a listed company may mitigate the risk of their investment in the shares decreasing in value by entering a short CFD position over those shares (i.e. the shares are the underlying asset for that CFD).
- 87 In this section we follow two hypothetical examples:
- (a) Tim trades CFDs; and
  - (b) Jenny invests in exchange traded funds (ETFs) (i.e. non-leveraged products that are traded on an exchange).
- 88 The first example (Tim) illustrates the potential significant losses that retail clients can incur when trading CFDs. The second example (Jenny) provides a comparison with a retail client that is trading ETFs.

**Tim trades CFDs: Example 1**

Tim is a retail client earning \$80,000 per year pre-tax from his full-time job.

Tim has been interested in trading shares and FX in the hope of generating some additional income and has recently started to trade CFDs. He shopped around and looked at several CFD issuers before opening an account with a licensed Australian issuer and depositing \$10,000.

**Jenny invests in ETFs: Example 1**

Jenny is a retail client earning \$50,000 per year pre-tax from her part-time job.

Jenny has been interested in trading shares in the hope of generating some additional income. She deposited \$10,000 into her online brokerage account.

**Most retail clients who trade CFDs lose money**

89 CFD issuers reported in our 2017 review that:

- (a) 63% of clients lost money trading margin FX; and
- (b) 72% of clients lost money trading other CFDs.

90 As outlined in paragraph 70, retail client losses from trading CFDs are a component of the \$1.5 billion gross trading revenue CFD issuers received in 2018.

91 Our evidence of client losses is broadly consistent with reported losses in other jurisdictions.

92 For example, the FCA reported that an estimated 78% of active retail client CFD accounts were loss-making, with total loss estimated at £1.07 billion a year. The FCA noted that other regulators in Europe reported similar poor results for retail clients.

Note: See FCA [CP18/38](#) *Restricting contract for difference products sold to retail clients and a discussion of other retail derivative products* (PDF 1001 KB), issued December 2018, at paragraph 2.9.

93 Studies carried out by other European national competent authorities (NCAs) also show that most retail clients in those jurisdictions trading in CFDs lost money: see Table 1.

**Table 1: Losses from CFDs in some other European jurisdictions**

Jurisdiction	Time period	% Loss	Average account loss
Ireland	2013–14	75%	€6,900
	2015–16	74%	€2,700
Cyprus	1 Jan 17 – 31 Aug 17	76%	€1,600
Spain	21 months early 2015 – late 2016	82%	€4,700
Poland	2016	79%	PLN10,060
	2017	80%	PLN12,156

Source: [Central Bank of Ireland Contracts for Difference Intervention Measure](#) (PDF 763 KB), in effect from 1 August 2019, at pp. 5,11 and 13.

94 The Central Bank of Ireland observed that retail clients generally were not sufficiently aware of the high risk and complex nature of the product.

## Potential for significant retail client losses

### High leverage ratios

95 High leverage ratios are unsuitable for retail clients. High leverage is one of the key risks of trading CFDs and is the primary cause of significant detriment to retail clients.

96 A leverage ratio is the ratio between the total notional CFD position value (that to which the retail client is exposed) and the amount deposited by the retail client (i.e. the minimum initial margin payment). The retail client is effectively in a similar position to ‘borrowing’ the remaining amount.

97 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. We commonly see leverage ratios of 200:1–500:1. This means that, for example, at a leverage ratio of 500:1 a retail client with a \$10,000 initial minimum margin requirement has a total position exposure of \$5 million.

98 Leverage ratios do not remain fixed over the life cycle of a CFD position. They fluctuate based on the price movements in the underlying asset and will increase rapidly with client losses.

99 Although a retail client only pays a fraction of the total notional value of their CFD position, they are entitled to the same gains and losses as if they paid 100% of the total notional value. This means that a retail client can lose more than their initial margin.

- 100 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.
- 101 High leverage ratios may also:
- (a) magnify fees and costs, because costs are generally calculated based on total notional position value (see paragraphs 115–118); and
  - (b) lead to higher frequency of trading (further increasing trading fees and costs) and greater losses by retail clients—a recent academic research paper by Boston and MIT professors provides causal evidence that the introduction of leverage limits by the US Commodity Futures Trading Commission (CFTC) has reduced the underperformance of retail margin FX traders in the United States (see paragraph 174).

### Tim trades CFDs: Example 2

#### Leveraged CFD position

Tim is convinced the broad Australian market is undervalued. He decides to take a long position on CFDs over the S&P/ASX 200 index at a leverage ratio of 200:1 and invests \$10,000 which gives Tim a \$2 million bet on the Australian market.

#### Leverage magnifying trading fees and costs

The CFD issuer charges a \$10 commission to open the CFD position and a spread of 0.05%. This spread applies to the entire leveraged exposure of \$2 million, which equals \$1,000. Tim's CFD account balance now sits at \$8,990, indicating that he would lose around 10% of his initial deposit if he wishes to close out his position.

#### Overnight funding costs

The market closes flat on the first day. Tim decides to give it more time for his forecast to play out.

The CFD issuer charges a 5% p.a. overnight funding cost for Tim's long position, which is akin to interest charged on borrowed funds and applies to the entire leverage exposure. This means that the CFD issuer will charge 5% of \$2 million divided by 365 days per day, which is around \$274.

This means that for each day Tim holds the position overnight he will be charged 2.74% of his initial deposit amount, which has the potential to quickly deplete his investment even if the market did not move.

Assuming the market is flat, and there is no dividend adjustment to Tim's CFD position, it would take only 33 days for the overnight funding costs to completely deplete Tim's initial deposit.

#### Leverage magnifying market risks

Tim starts the second day with \$8,716 in his CFD account. The S&P/ASX 200 index falls slightly by 0.2% during the day. Given the 200 times leverage, Tim

incurs a trading loss of \$4,000, which accounts for 40% of his initial deposit. Tim's account now has \$4,716.

It is worth noting that Tim now has a \$1.996 million position (\$2 million position with a 0.2% decrease), but only \$4,716 in his CFD account. This effectively corresponds to a 423:1 leverage ratio. Tim is now even more sensitive to market volatility than when he opened the position.

### Jenny invests in ETFs: Example 2

#### Unleveraged position

Jenny also believes the Australian market is undervalued. She decides to take a long position on an ETF tracking the S&P/ASX 200 index. Jenny's exposure to the ETF is \$10,000, compared to Tim's exposure of \$2 million to the CFD.

#### Trading fees and costs

The broker charges \$10 commission to open the position. Assuming Jenny is aggressive instead of passive in her trading and crosses the 0.05% spread, this would cost her another \$5.

#### Overnight funding costs

Jenny is not charged any interest on her position.

#### Market risks

The S&P/ASX 200 index falls slightly by 0.2% during the day. Jenny is down \$20. Jenny has paid a total of \$10,010 and her ETF is worth \$9,980.

### Automatic close-outs at low margin levels

- 102 CFD issuers usually set a 'liquidation' level, which is the level at which an open CFD position is closed 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. In some circumstances, the retail client's loss on that position once it is automatically closed out may exceed their investment, which means they owe money to the issuer.
- 103 In our 2019 review we found that during the period 1 January 2018 to 31 December 2018:
- (a) there were over 9.3 million positions that were automatically closed out by CFD issuers for around 1 million active clients;
  - (b) there were over 41,000 CFD trading accounts that went into negative balance (i.e. the retail client owed money to the CFD issuer); and
  - (c) the total negative balance (i.e. the total amount owed by those retail clients) was over \$33 million.

- 104 Analysis by the UK FCA showed that for the currency pair USD/GBP, at a leverage ratio of 500:1 and a 50% automatic margin close-out, retail clients who do not make an additional investment over a two-hour span would:
- (a) be automatically closed out and 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.

Note: See FCA [CP16/40](#) *Enhancing conduct of business rules for firms providing contract for difference products to retail clients*, issued December 2016.

#### *Stop-loss (or other similar) orders*

- 105 CFD issuers may offer retail clients certain types of orders, such as ‘stop-loss’ orders or ‘guaranteed stop-loss’ orders, which are promoted as a means of capping potential losses. Generally, these types of orders allow a retail client to pre-set a price to close out their CFD position. Clients pay a fee when entering a guaranteed stop-loss order for a CFD position (similar to an option premium for a call or put option).
- 106 Ordinary ‘stop-loss’ orders do not remove all the risk of significant losses. The retail client’s position may not be closed out at the nominated price (e.g. if there is lack of liquidity in the underlying market, or if there are price ‘gaps’): see paragraphs 111–113.

### **Risk of losses which are greater than the retail client’s initial investment**

#### **Margin calls**

- 107 If changes in the market value of the underlying asset have a negative effect on the retail client’s open CFD position, the CFD issuer may require the retail client to deposit additional money into their CFD trading account (i.e. to meet their margin requirement). This is known as a ‘margin call’ and may be made by the CFD issuer at short notice to the retail client. Retail clients who fail to ‘top up’ their account within the relatively short timeframe provided may see their position automatically closed out by the CFD issuer: see paragraph 102.
- 108 When ‘margin calls’ are triggered in close succession (e.g. if the underlying asset price continues to move against the position like in a ‘flash crash’), the amount of cumulative losses incurred by retail clients can significantly exceed the amount they initially intended to commit to the CFD position.

**Tim trades CFDs: Example 3****Margin call**

Tim receives a call from the CFD issuer to say that his CFD account balance is too low (being less than 50% of the initial margin) and he will need to top up his CFD account with additional funds.

Tim is reluctant to realise his losses and still believes in his forecast of the market. He deposits another \$5,000 into the account, which means his balance is now \$9,716.

**Jenny invests in ETFs: Example 3**

Jenny is not at risk of mandatory close-out because she is not trading on margin.

**Liquidity risk**

109 Liquidity (i.e. the volume of orders and trades) in the market for a CFD's underlying asset can affect a retail client's ability to trade CFDs over that asset. There is a risk that the CFD issuer may decline a retail client's order or only agree to execute the order at an inferior price.

110 A lack of liquidity can occur at the time of opening or closing a CFD position. For example, a retail client could be left with an open CFD position which they are unable to close. This increases the likelihood of potential losses and may cause clients to have negative equity—meaning that they unexpectedly owe money to the CFD issuer.

**Slippage and gapping**

111 'Slippage' refers to instances where the price at which the CFD order is executed differs from the price quoted (i.e. slippage). This may, for example, occur when there is lack of liquidity in the market for the underlying asset. If the market moves in the time between placement and execution of the CFD order, the retail client's CFD order could be executed at a worse price. This increases the likelihood of potential losses.

112 'Gapping' refers to circumstances where the underlying market price moves in large and discrete steps and skips one or more price points. This may occur following the publication of economic data or significant economic events that lead to major price volatility of the underlying asset (e.g. on 15 January 2015 the Swiss National Bank unpegged the Swiss franc from the euro causing the currency pair to soar instantly). When gapping occurs, a retail client may not be able to close their CFD position at a price between the two price levels (i.e. the gap). Instead, the next available price is that determined by the CFD issuer.

- 113 For example, the price of a stock could fall from \$2.54 to \$2.50 without trading at any of the prices in between. If a retail client enters an order to close their long CFD position at \$2.52 (e.g. if a stop-loss is used), their order may only be executed at \$2.50 (or less) (depending on the order type and the capabilities of the CFD issuer's trading systems).
- 114 The extremely high leverage offered in CFDs to retail clients means that even small adverse movements in the value of the underlying asset can lead to significant losses for retail clients. Therefore, in circumstances where 'gapping' occurs and there is a substantial movement in price, the magnitude of the losses can place the retail client into significant sudden financial distress and negative equity.

#### Tim trades CFDs: Example 4

##### Negative equity

On the third day, an unexpected major global event causes the market to gap down by 1%. As a result of the sharp sudden drop in the price of the underlying asset, the CFD issuer and Tim do not have the opportunity to react. This results in another \$19,960 loss for Tim, and the CFD account goes into negative balance of \$10,244.

##### Overall outcome

In addition to losing both the initial \$10,000 and \$5,000 margin top up, Tim now owes the CFD issuer \$10,244. In total, Tim lost \$25,244, which is over 250% of his initial deposit, when the market fell only 1.2%.

Fees and charges accounted for \$1,557 (\$1,000 spread + \$274 funding + \$273 funding + \$10 commission), which is 15.6% of Tim's initial deposit.

While other retail clients of the CFD issuer may have taken the opposite market view to Tim's forecast and made leveraged profits, this hypothetical example illustrates the high risks associated with leveraged CFD products as they currently exist and the impact of spreads, commission and overnight funding costs. In fact, for retail clients taking short positions in CFDs the potential for loss is infinite.

#### Jenny invests in ETFs: Example 4

On the third day, an unexpected major global event causes the market to gap down by 1%. Jenny is down another \$99.80. It is impossible for Jenny to lose more than the amount she invested.

##### Overall outcome

Jenny has lost \$134.80, under the same market conditions as Tim, if she decides to sell her holdings.

Fees and charges accounted for \$15 (\$5 spread + \$10 commission), which is 0.15% of Jenny's invested amount.

## **Fees and costs lack transparency, are magnified by leverage and can deplete the retail client's investment**

- 115 CFD issuers impose a range of fees and costs on retail clients, including:
- (a) 'spread', which is the difference between the buy price and the sell price quoted for a CFD—the buy price quoted is lower than the sell price quoted, and the underlying market price will generally rest between these two prices;
  - (b) 'commission', which is the fee (often expressed as a percentage) charged by a CFD issuer on entering into each CFD contract;
  - (c) 'overnight funding costs', which are the costs charged by a CFD issuer when the retail client holds a CFD position open overnight—some or all of which may be offset by benefits of holding a CFD position overnight (e.g. positive carry on a margin FX CFD or a dividend adjustment on a long index CFD); and
  - (d) 'FX conversion', which is the rate at which a CFD issuer will convert fees and profit/loss from the position's base currency, to subtract from (or deposit into) the AUD denominated account.

116 Fees and costs (such as commissions and overnight funding costs) are generally calculated based on the total position value of the CFD contract. High leverage ratios can therefore magnify fees and costs. These fees can significantly and quickly deplete a retail client's investment. For example, in Example 4, Tim incurred fees and charges worth 15.6% of his three-day investment.

117 We have found that the amount of overnight funding costs that can be imposed are often not clearly disclosed by CFD issuers and not fully understood by retail clients. During a surveillance activity, we observed that some retail clients incurred excessively high overnight funding costs for certain CFD positions.

118 In Example 2, Tim's initial deposit of \$10,000 was immediately reduced by over \$1,000 due to the costs of opening his CFD position. Due to high overnight funding costs, Tim's CFD account balance was reduced by a further \$273 on the second day that his position was open. Assuming the market was flat, and there was no dividend adjustment on Tim's CFD position, it would take only 33 days for the overnight funding costs to completely deplete Tim's initial deposit of \$10,000.

## **Unclear pricing methodologies**

119 CFD issuers 'make a market' in CFDs. This means that the CFD issuer determines the bid-ask spreads of the underlying instruments that are traded by retail clients through the CFD issuer's trading platform. Generally, there

is an expectation among retail clients that the prices quoted will closely follow the underlying market.

- 120 In REP 579 we noted that CFD issuers often had unclear and confusing pricing methodologies leading to the sale to retail clients of products that misaligned with their understanding and expectations. We have also received reports from retail clients about unfair pricing practices.

## Our regulatory actions to date

- 121 We have taken strong and frequent action, and applied a range of our existing regulatory tools, to address our concerns in relation to the issue of binary options and CFDs in or from Australia to retail clients. These include:
- (a) enforcement action to address instances of misconduct;
  - (b) public warning notices and other statements;
  - (c) surveillance projects and thematic reviews;
  - (d) stronger regulations, including the ASIC Client Money Reporting Rules 2017 which commenced on 4 April 2018; and
  - (e) extensive retail client education campaigns and guidance for issuers of binary options and CFDs.
- 122 Our evidence shows that, despite ASIC's actions in relation to binary options and CFDs in the last 10 years, significant detriment to retail clients continues and, in some circumstances, is increasing.
- 123 In Appendix 1 we outline the key actions we have taken to date.

## D International measures in relation to binary options and CFDs

### Key points

Our concerns about binary options and CFDs, and the significant detriment to retail clients caused by trading these high-risk products, are not unique to the Australian market.

IOSCO recently published a toolkit which is intended to be used by regulators to enhance protections for retail clients.

An increasing number of foreign regulators have implemented, or are planning to implement, measures to prohibit or restrict the offer of binary options and CFDs.

We will continue to closely monitor for 'regulatory arbitrage' and other potential avoidance practices. If significant consumer detriment persists we will consider further intervention.

### IOSCO's regulatory toolkit to enhance protections for retail clients

- 124 IOSCO's report on retail OTC leveraged products sets out a regulatory toolkit that IOSCO members may consider in the regulation of retail OTC derivatives issuers: see IOSCO, [Report on retail OTC leveraged products](#) (PDF 988 KB), final report, September 2018 (IOSCO toolkit).
- 125 The IOSCO toolkit comprises nine policy measures which are designed to:
- (a) help reduce the risk to retail clients;
  - (b) improve practices of retail OTC derivatives issuers;
  - (c) improve the likelihood that OTC derivatives are sold to an appropriate target market; and
  - (d) reduce the likelihood that these products are sold illegally by unlicensed entities.
- 126 Our proposed market-wide product intervention orders in relation to binary options (see Proposal E1) and CFDs (see Proposal F1) are largely consistent with the range of policy measures set out in the IOSCO toolkit. In Table 2 we summarise each of IOSCO's nine policy measures and compare them with our proposals.

**Table 2: The IOSCO regulatory toolkit to enhance protections for retail clients**

IOSCO measure	Description of measure	Comparison with ASIC's proposals
Measure 1: Requirement for firms offering the relevant products to retail investors to be licensed	The measure would require market intermediaries to be registered and/or licensed by a relevant regulatory authority when physically based in and operating from that jurisdiction and offering the relevant products to retail clients, regardless of where the end-client is located.	There are existing AFS licensing obligations for retail OTC derivatives issuers
Measure 2: Requirement for firms to incorporate a prescribed minimum margin requirement for retail investors	This measure would require market intermediaries to comply with minimum margin requirements when transacting in CFDs or rolling spot forex contracts, ensuring that they collect from their clients a certain margin amount as collateral before opening a position. This measure can also be applied so that it requires a certain level of margin to be maintained to support a position over the course of the trade.	See CFDs—Proposal F1 <b>Condition 1—Leverage ratio limits</b> <b>Condition 2—Margin close-out protection</b>
Measure 3: Negative balance protection	This measure would require market intermediaries to limit retail clients' losses in CFDs and rolling spot forex contracts to their deposited funds or their funds invested for each trade, thereby preventing firms from recovering any losses that exceed the clients' deposited funds or funds invested for each trade.	See CFDs—Proposal F1 <b>Condition 3—Negative balance protection</b>
Measure 4: Prescribed disclosures setting out the total costs of the product	This measure would require market intermediaries to provide a standardised disclosure that clearly sets out the total costs and charges charged by intermediaries relating to the product before it is sold to retail clients.	See CFDs—Proposal F1 <b>Condition 7—Real-time disclosure of overnight funding costs</b> While CFD trading costs are generally sufficiently disclosed in PDSs and/or CFD trading platforms, disclosure of overnight funding costs is unclear
Measure 5: Disclosure of investor profit and loss ratios	This measure would require market intermediaries to disclose to their clients the percentage of client accounts that made a net profit or loss during a certain period of trading activity.	See CFDs—Proposal F1 <b>Condition 5—Risk warnings</b>

IOSCO measure	Description of measure	Comparison with ASIC's proposals
Measure 6: Adoption of a fair pricing methodology and use of externally verifiable price sources	This measure would require market intermediaries to be able to demonstrate a clear pricing methodology for the relevant products and to use independent and externally verifiable price sources and liquidity providers to derive their prices.	See CFDs—Proposal F1 <b>Condition 8—Transparent pricing and execution</b>
Measure 7: Enhanced disclosures about order execution quality	This measure would require that market intermediaries provide clear disclosure to their clients about how their orders are executed.	See CFDs—Proposal F1 <b>Condition 5—Risk warnings</b> <b>Condition 6—Real-time disclosure of total position size</b> <b>Condition 8—Transparent pricing and execution</b>
Measure 8: A ban or restrictions on certain forms of marketing or sales techniques for relevant products	This measure would involve placing restrictions on certain forms of marketing or sales techniques used by market intermediaries offering some or all of the relevant products to retail clients.	See CFDs—Proposal F1 <b>Condition 4—Prohibition on inducements</b>
Measure 9: A ban or restriction on the sale and/or distribution of the relevant products by intermediaries	This measure would prohibit or restrict the sale and/or distribution of some or all of the relevant products to retail clients by market intermediaries or require transactions on the relevant products to take place on exchanges.	See binary options—Proposal E1 <b>Prohibition on the issue and distribution of binary options to retail clients</b>

Source: [IOSCO toolkit](#) (PDF 988 KB).

## Measures implemented by foreign regulators on OTC binary options

- 127 Foreign regulators such as ESMA, the FCA and the Canadian Securities Administrators (CSA) have implemented measures which prohibit or restrict the issue of OTC binary options to retail clients.
- 128 ESMA first exercised its temporary intervention powers to prohibit the issue of binary options to retail clients on 2 July 2018. On 1 July 2019 ESMA announced that the temporary prohibition had ceased to take effect, as most regulators in Europe had implemented permanent measures in their own jurisdictions that were at least as stringent as its temporary prohibition: see media release [ESMA ceases renewal of product intervention measure relating to binary options](#), issued July 2019.

129 Table 3 provides a summary of some of the existing measures implemented by foreign regulators in relation to OTC binary options. In relation to the European regulators that have implemented permanent measures in their own jurisdictions, we have included the United Kingdom as an example.

**Table 3: Existing measures implemented by foreign regulators for OTC binary options**

Regulator	Existing measures
FCA (United Kingdom)	FCA has permanently prohibited the sale, marketing and distribution of binary options to retail clients by firms that carry out activity in, or from, the United Kingdom. The ban took effect on 2 April 2019.  See FCA policy statement <a href="#">PS19/11</a> <i>Product intervention measures for retail binary options</i> (PDF 636 KB), issued March 2019
Canadian Securities Administrators (CSA) (Canada)	CSA has prohibited binary options trading where the contract duration is less than 30 days.  See CSA <a href="#">Multilateral Instrument 91-102</a> <i>Prohibition of binary options and related companion policy</i> , dated 28 September 2017
Commodity Futures Trading Commission and Securities and Exchange Commission (USA)	Binary options are covered by legislation on swaps or securities-based swaps and may typically only be offered to retail clients on exchange (i.e. OTC is not permitted).

## Measures implemented by foreign regulators on OTC CFDs

130 ESMA introduced temporary product intervention powers imposing, from 1 August 2018 to 31 July 2019, the following restrictions on the marketing, distribution or sale of CFDs to retail clients:

- (a) leverage ratio limits on the opening of a CFD position by a retail client:
  - (i) 30:1 for major currency pairs;
  - (ii) 20:1 for non-major currency pairs, gold and major indices;
  - (iii) 10:1 for commodities other than gold and non-major equity indices;
  - (iv) 5:1 for individual equities and other reference values; and
  - (v) 2:1 for cryptocurrencies;
- (b) a margin close-out rule on a per account basis;
- (c) negative balance protection on a per account basis;
- (d) a restriction on the incentives offered to trade CFDs; and
- (e) a standardised risk warning.

131 ESMA announced that it allowed its temporary measures to cease on 31 July 2019 as most NCAs in the European Union had implemented permanent product intervention measures relating to CFDs that were at least as stringent.

Note: See [ESMA ceases renewal of product intervention measures relating to contracts for differences](#), issued 31 July 2019.

132 For example, the FCA has implemented permanent measures to restrict how CFDs and CFD-like options (such as ‘turbo certificates’) are marketed, distributed, and sold to retail consumers. The FCA’s measures are largely the same as the restrictions imposed by ESMA. One point of difference is the FCA’s decision to apply a 30:1 leverage ratio limit for CFDs referencing certain government bonds, in contrast with the 5:1 leverage ratio limit specified in ESMA’s measures.

Note: See FCA policy statement [PS19/18](#), *Restricting contracts for difference products sold to retail clients* (PDF 581 KB), issued July 2019.

133 Some other European authorities have implemented or proposed CFD leverage ratio limits that differ according to the experience of a retail client. For example, in Poland ‘experienced clients’ may open CFD positions with leverage as high as 100:1 for currency pairs, while CySEC proposes leverage limits up to 50:1 for retail clients in Cyprus with enhanced trading experience.

134 Regulators in the Asia-Pacific region and Canada have imposed leverage ratio limits on CFDs sold to retail clients. The United States limits CFDs that are available to retail clients to rolling spot FX contracts. Some regulators have a complete prohibition on trading by retail clients in certain OTC CFDs. These measures are summarised in Table 4.

**Table 4: Leverage ratio limits and other restrictions implemented by other regulators**

Regulator	Leverage ratio limit or other restriction
Monetary Authority of Singapore	Leverage ratio limits of: <ul style="list-style-type: none"> <li>• 20:1 for margin FX;</li> <li>• 20:1 for CFDs over indices;</li> <li>• 10:1–5:1 for CFDs over equities; and</li> <li>• 5:1 for CFDs over other reference instruments</li> </ul> Note: Adjusted leverage ratio limits apply if the retail OTC derivatives issuer offers guaranteed stop-losses.
Hong Kong Securities and Futures Commission	Margin FX leverage ratio limit of 20:1 CFDs over other reference instruments prohibited
Japan Financial Services Agency	Leverage ratio limits of: <ul style="list-style-type: none"> <li>• 25:1 for margin FX; and</li> <li>• 5:1–50:1 for other CFDs depending on the reference instrument</li> </ul>

Regulator	Leverage ratio limit or other restriction
South Korea Financial Supervisory Service	Margin FX leverage ratio limit of 10:1 CFDs over other reference instruments prohibited
Various authorities in China, including the China Securities Regulatory Commission and the State Administration of Foreign Exchange	Not permitted on the basis no licence has been issued for issuing of these products in China
CFTC and the National Futures Association in the United States	On exchange rolling spot FX contracts leverage ratio limits of: <ul style="list-style-type: none"> <li>• 50:1 for major currency pairs; and</li> <li>• 20:1 for other currency pairs</li> </ul>
Investment Industry Regulatory Organization of Canada (IIROC)	Leverage ratio limits for margin FX based on underlying currency pair (regularly updated by IIROC)

## Crypto-asset CFDs

- 135 Some regulators are considering interventions relating to crypto-asset CFDs and other derivatives over crypto-assets. For example, the FCA is consulting on a proposal to prohibit the sale of all derivatives over crypto-assets to retail clients. ASIC is monitoring these developments.

Note: See FCA [CP19/22](#), *Prohibiting the sale to retail clients of investment products that reference crypto-assets*, issued July 2019.

## Regulatory arbitrage

- 136 ‘Regulatory arbitrage’ refers to persons attempting to benefit from differences in regulation between jurisdictions. For example, an entity may establish a subsidiary in a jurisdiction that it perceives has more lenient regulatory requirements and then direct its clients to transact through that subsidiary.
- 137 We suspect that our relatively lighter touch regulation of binary options and CFDs has resulted in issuers routing overseas clients to their Australian licensed entities. This could help to explain the significant growth in clients of Australian issuers between the 2017 and 2019 metric reviews (121% increase to around 1 million: see Figure 1), of which 83% are based overseas: see Figure 2.
- 138 We are working closely with overseas regulators to address illegal activity, regulatory arbitrage and other activity designed to circumvent regulation in other jurisdictions.

- 139 This includes addressing avoidance practices that have been observed in other jurisdictions, such as product arbitrage—the creation of new products, with similar characteristics or risks as binary options and CFDs, that are sold under a different name or description, or as an alternative to binary options or CFDs.
- 140 Some overseas regulators have also observed that some binary options and CFD issuers have reclassified their retail clients to professional clients.
- 141 Indeed, we are observing this transition in Australia. In the 2019 review we asked binary options and CFD issuers to provide us with the number of retail clients that had been reclassified as wholesale clients in the period 1 January 2018 to 31 March 2019. We found that almost 9,200 retail clients had been reclassified as wholesale clients during this period. This is concerning because wholesale clients do not receive the same protection as retail clients. We are also concerned that these clients may not be aware that retail protections no longer apply to them.
- 142 We will continue to closely monitor for ‘regulatory arbitrage’, and other potential avoidance practices by issuers which undermine or attempt to work around the intended purpose of our proposed intervention. If significant consumer detriment persists we will consider further intervention.

## E Proposed product intervention: Binary options

### Key points

We propose to make a market-wide product intervention order which prohibits the issue and distribution of binary options to retail clients.

We consider binary options have resulted in, and are likely in future to result in, significant detriment to retail clients.

The order will address our concerns about the inherent risks of these products by removing the possibility for retail clients to trade them and to make losses.

Our proposed intervention is consistent with measures taken in other jurisdictions.

### Prohibition on the issue and distribution of binary options to retail clients

#### Proposal

- E1 We propose to exercise our product intervention powers in Pt 7.9 of the Corporations Act to make a market-wide product intervention order, in force for 18 months, which prohibits the issue and distribution of binary options to retail clients and requires that existing retail clients are notified of the terms of the order. We propose that the product intervention would take effect 10 business days after the day on which the legislative instrument is registered.

See the draft market-wide product intervention order relating to binary options in Attachment 1 (on our website under [CP 322](#)).

#### *Your feedback*

- E1Q1 Do you agree with our proposal to make a market-wide product intervention order which prohibits the issue and distribution of binary options to retail clients? If not, why not? If you disagree that binary options 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.
- E1Q2 Do you agree with our proposal that the order would remain in force for a period of 18 months? If not, why not?

E1Q3 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?

E1Q4 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?

## Rationale

### Significant detriment resulting from binary options

143 In Section C we explained that we consider binary options have resulted in, and are likely in future to result in, significant detriment to retail clients.

### Our proposed intervention

144 We consider that our proposed intervention is the most appropriate regulatory solution to reduce the significant detriment retail clients have suffered and are likely to suffer in future. Due to the nature, likelihood and extent of significant detriment to retail clients, the proposed order should take effect soon after it is made.

145 In our view, binary options provide no meaningful investment or economic utility. Unlike other types of OTC derivatives or exchange traded products, binary options do not offer participation in the growth in value of the underlying asset. The typical ‘all-or-nothing’ payoff structure of binary options also makes them unsuitable for risk management arrangements such as hedging. It is for these reasons that we think a prohibition is the most appropriate intervention (rather than imposing certain conditions as we have proposed for CFDs).

146 We do not propose to exempt any types of binary options from our proposed intervention—in contrast to some other jurisdictions. For example, ESMA excluded from their prohibition, binary options with a contract duration of 90 days or more. The CSA’s prohibition excludes contracts with a duration of 30 days or more: see Table 3.

147 The typical short-term contract duration of binary options is only one of several product features contributing to the significant detriment to retail clients. There are no appreciable benefits (such as investment or risk management) other than facilitating speculation with negative expected returns. Allowing some form of binary options to exist will mean that retail clients are still exposed to the risk of significant losses trading this product.

148 In our view, allowing an exemption for binary options of longer contract term does not go far enough to address the significant detriment to retail clients caused by the fundamental design flaws of binary options and the key risks associated with trading them.

- 149 Our proposal is consistent with Measure 9 ‘A ban or restriction on the sale and/or distribution of the relevant products by intermediaries’ of the [IOSCO toolkit](#) (PDF 988 KB).
- 150 It is also consistent with measures implemented by other regulators such as the FCA: see Table 3. With 83% of retail OTC derivatives issuers’ clients based overseas (see Figure 2), having consistency with our peer regulators will help to address our regulatory arbitrage concerns.
- 151 Binary options issuers must take reasonable steps to notify their clients of the terms of the order within five business days of commencement of the order: see section 6 of the draft market-wide product intervention order in Attachment 1 (on our website under [CP 322](#)).
- 152 We estimate that our proposed market-wide prohibition could prevent retail clients trading with licensed binary options issuers in Australia from incurring further losses of as much as \$490 million per year: see paragraph 70. Public notice of the proposed product intervention order (if made) may also reduce the risk of fraud, and associated losses, by unlicensed entities claiming to offer binary options to Australian clients.

### **Competition effects**

- 153 Our proposed product intervention will effectively mean that binary options will no longer be lawfully available for acquisition by retail clients in Australia. We expect that this strong measure will reduce harms suffered by retail clients resulting from binary options.
- 154 We consider binary options are unsuitable to be offered as an investment product to retail clients. This is due to their negative expected return, lack of pricing transparency and the absence of any meaningful investment or economic utility. Therefore, we consider these products do not support meaningful competition for the benefit of consumers.
- 155 If our proposed product intervention is implemented, retail clients will continue to have access to alternative investment products, including other classes of OTC derivatives (such as OTC CFDs) or exchange traded products.
- 156 A benefit of imposing a market-wide prohibition is that it applies to all issuers of binary options equally.
- 157 We are only aware of one licensed issuer in Australia that exclusively offers binary options. Our proposed intervention will have a material impact on this entity’s business in Australia as it will not be able to offer and generate revenue from this product in Australia.
- 158 There are also four issuers that offer binary options along with other products and there will be some impact on their revenue. However, any lost revenue from these products would be losses avoided by retail clients.

## F Proposed product intervention: CFDs

### Key points

We propose to make a market-wide product intervention order which imposes certain conditions on the issue and distribution of CFDs to retail clients.

We consider that certain features of CFDs have resulted in, and are likely in future to result in, significant detriment to retail clients.

The proposed order will limit leverage, protect against negative balances and implement a standardised approach to the automatic close-out of retail client positions. This will reduce retail client overall exposure, the fees they pay and ultimately the volume of losses.

The proposed order will also prohibit giving or offering retail clients certain inducements to trade CFDs and improve transparency of pricing, execution and risks.

Our proposed intervention is largely consistent with measures taken in other jurisdictions.

### Imposing certain conditions on the issue and distribution of CFDs to retail clients

#### Proposal

F1 We propose to exercise our product intervention powers in Pt 7.9 of the Corporations Act to make a market-wide product intervention order, in force for 18 months, which imposes Conditions 1–8 (set out in Table 5) on the issue and distribution of CFDs to retail clients and requires that existing retail clients are notified of the terms of the order. The order and Conditions 1, 3, 4 and 5 (except trading platform risk warnings) will take effect 20 business days after the day on which the legislative instrument is registered. All other conditions will take effect three months after the day on which the legislative instrument is registered.

See the draft market-wide product intervention order relating to CFDs in Attachment 2 (on our website under [CP 322](#)).

*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?

**Table 5: Conditions on the issue and distribution of CFDs to retail clients**

Condition	Requirement
1. Leverage ratio limits	<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>• 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 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>See section 5 and subsection 7(3) of the draft market-wide product intervention order in Attachment 2 (on our website under <a href="#">CP 322</a>).</p>
2. Margin close-out protection	<p>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.</p> <p>See section 5 and subsections 7(4)–(6) of the draft market-wide product intervention order in Attachment 2.</p>
3. Negative balance protection	<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>See section 5 and subsection 7(7) of the draft market-wide product intervention order in Attachment 2.</p>
4. Prohibition on inducements	<p>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.</p> <p>However, the prohibition would not cover information services or educational or research tools.</p> <p>See section 6 of the draft market-wide product intervention order in Attachment 2.</p>
5. Risk warnings	<p>A CFD issuer must provide a prominent risk warning to retail clients and prospective retail clients on all account opening forms, PDSs, any trading platforms maintained by the CFD issuer and websites relating to CFD trading which, at a minimum:</p> <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> <p>See section 5, subsections 7(8)–(12) and Schedule 1 of the draft market-wide product intervention order in Attachment 2.</p>

Condition	Requirement
6. Real-time disclosure of total position size	<p>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.</p> <p>See section 5 and subsection 7(13) of the draft market-wide product intervention order in Attachment 2.</p>
7. Real-time disclosure of overnight funding costs	<p>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.</p> <p>See section 5 and subsection 7(14) of the draft market-wide product intervention order in Attachment 2.</p>
8. Transparent pricing and execution	<p>A CFD issuer must maintain and make available on its website a CFD pricing methodology and a CFD execution policy.</p> <p>The CFD pricing methodology must explain how the CFD issuer determines its CFD prices, including:</p> <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> <p>See section 5 and subsection 7(15) of the draft market-wide product intervention order in Attachment 2.</p>

## Rationale

- 159 In Section C we explained that we consider CFDs have resulted in, and are likely in future to result in, significant detriment to retail clients.
- 160 We consider that our proposed intervention is the most appropriate regulatory solution to reduce the significant detriment to retail clients, and the likelihood of this significant detriment occurring in future.
- 161 Unlike binary options, CFDs can serve legitimate trading, investment and risk management purposes where appropriate protections are in place for retail clients (e.g. to hedge exposure to positions in the CFD's underlying asset). It is for this reason that we think imposing restrictions on this product is more appropriate than an outright prohibition.
- 162 Conditions 1–8 of our proposed order, taken as a package, constitute a holistic approach which is intended to mitigate some of the risks of CFDs and resulting significant detriment to retail clients. Our conditions will standardise certain practices across all CFD issuers.

- 163 Specifically:
- (a) Conditions 1–3 are intended to constrain certain product features that may amplify retail clients’ losses;
  - (b) Condition 4 is intended to prohibit inappropriate marketing practices; and
  - (c) Conditions 5–8 are intended to improve transparency and limit practices that may confuse retail clients.

164 Conditions 1–8 are consistent with the range of policy measures set out in [IOSCO’s toolkit](#) (PDF 988 KB) (see Table 2) and introduced by ESMA and other foreign regulators (see paragraphs 130–134 and Table 4). This will help to address our concerns in relation to regulatory arbitrage: see paragraphs 136–143.

165 Conditions 6 and 7 address additional concerns we have identified in our surveillance activities. If implemented, to our knowledge, Australia will be the first jurisdiction to implement product intervention measures of this nature.

166 Due to the nature, likelihood and extent of significant detriment to retail clients, the proposed order should take effect shortly after it is made. However, it needs to allow a reasonable period for the implementation of certain conditions that may require system and process changes.

167 CFD issuers must take reasonable steps to notify their clients of the terms of the order within five business days of commencement of the order: see section 8 of the draft market-wide product intervention order in Attachment 2 (on our website under [CP 322](#)).

168 In [CP18/38](#) at paragraph 2.25, the FCA commented on the impact of ESMA’s measures to reduce retail client detriment in the United Kingdom. The FCA observed fewer retail clients trading CFDs, with an overall reduction in trading volumes and lower retail client losses. The FCA also observed that there had been fewer automatic margin close-outs, and fewer retail clients lost all of their invested funds. ESMA’s success in reducing harms to retail investors further supports the need for, and likely impact of, making our proposed order.

169 The FCA has also estimated that its CFD intervention measures could save UK retail clients up to £451 million per year. We expect that our proposed measures would lead to proportionally similar savings for Australian retail clients.

Note: See FCA [PS19/18](#) (PDF 581 KB) at paragraph 1.17.

170 Consistent with the above analysis, ASIC has received intelligence from CFD issuers that have analysed the impact of the introduction of overseas

leverage limits on their business and clients, which shows the positive impacts of leverage limits on client outcomes. They show that leverage ratio limits can result in a significant reduction in the number of positions that are automatically closed, a significant reduction in client losses and clients trading more profitably.

### **Condition 1: Leverage ratio limits**

171 Limiting retail clients' exposure by setting leverage ratio limits protects both the retail client and the CFD issuer. It significantly reduces:

- (a) the potential magnitude of retail client losses and the speed in which such losses may be incurred; and
- (b) counterparty risk of the issuer to retail clients caused by offering excessive leverage to other retail clients.

172 In reaching our proposed leverage ratio limits (set out in Table 6) we considered:

- (a) academic research;
- (b) correlation analysis between leverage and several client detriment metrics, such as automatic close-outs;
- (c) the impact leverage ratio limits have had in other jurisdictions on reducing retail client losses;
- (d) the categories of underlying assets for CFDs and the volatility of those underlying assets;
- (e) leverage ratio limits set by other regulators (such as ESMA, FCA and regulators in the Asia-Pacific region) and analysis undertaken by those regulators to determine those ratios;
- (f) simulations of the probability of margin close-out (see paragraphs 230–235 and Figure 7, Figure 8 and Figure 9); and
- (g) the benefits of mitigating regulatory arbitrage, which has also been a key driver.

173 Condition 1 is consistent with Measure 2 'Requirement for firms to incorporate a prescribed minimum margin requirement for retail investors' of the [IOSCO toolkit](#) (PDF 988 KB).

#### *Academic research on harm reduction from leverage ratio limits*

174 A recent academic research paper by Boston and MIT professors provides causal evidence that the introduction of leverage limits by the CFTC has reduced the underperformance of retail margin FX traders in the United States. 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%.

Note: See Rawley Z Heimer and Alp Simsek 2019, 'Should retail investors' leverage be limited?', *Journal of Financial Economics*, vol 132, no. 3.

175 This academic research is further supported by the FCA's independent analysis of the impact of leverage limits on client outcomes using firm data. Their analysis found that low leverage encouraged retail consumers to trade at lower volumes resulting in fewer losses.

Note: See [CP18/38: Technical annex](#) (PDF 582 KB), issued December 2018.

*Correlation analysis linking leverage to retail client detriment*

176 Using data that we collected from the 2019 review, we conducted linear regression analysis based on CFDs over different underlying assets. This allowed us to examine the correlation between leverage and several client detriment metrics after controlling for the impact of other relevant variables.

177 In our analysis we looked at the relationship between negative retail client outcomes such as automatic close-out or losing money on a CFD position (i.e. the dependent variables) and leverage, after controlling for the independent variables (i.e. CFD issuer, number of transactions and CFD product category). We also looked at the relationship between how profitable the product is for the CFD issuers (measured by their gross trading revenue less remuneration paid to referrers) and leverage after controlling for the same variables.

178 In our analysis we found that leverage had a positive correlation to both client detriment metrics and issuer profitability. 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.

*Positive impacts of leverage ratio limits in other jurisdictions*

179 In [CP18/38](#) (PDF 1001 KB) at paragraphs 3.36–3.37, the FCA stated that the application of ESMA's leverage ratio limits has 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 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.

180 In South Korea, minimum initial margin requirements for margin FX CFDs were increased to discourage retail clients from indiscreet speculation in excessively leveraged margin FX contracts. Leverage ratio limits tightened from 50:1 to 20:1 in 2009, and to 10:1 in 2011. The South Korean Financial Supervisory Service (FSS) has observed year-on-year declines in margin FX trading volumes following the changes. Retail client losses in South Korea also fell with the lower leverage ratio limits; however, the percentage of retail client accounts that are loss-making remains significant.

*Rationale for our proposed leverage ratio limits and international comparisons*

181 Table 6 sets out our proposed leverage ratio limits, our rationale for setting those limits and a comparison with other jurisdictions.

**Table 6: Rationale for leverage ratio limits and international comparisons**

Underlying asset category	Leverage ratio limit	Rationale and international comparisons
Currency pairs	20:1	Unlike ESMA and FCA, we do not propose to distinguish between major and minor currency pairs. A single leverage ratio limit for all currency pairs will be simpler to implement and supervise and is consistent with regulators in the region, including Japan (25:1), Hong Kong and Singapore (20:1), and South Korea (10:1). Regional alignment may assist to limit regulatory arbitrage.
Equity indices	15:1	Our leverage ratio limit is based on our simulations on Australian equity indices (see Appendix 2, Figure 7 and Figure 8). While we considered a 10:1 ratio for minor indices and 15:1 for major indices based on the simulations, we decided to propose 15:1 for all indices for simplicity in implementation and supervision.
Commodities (excluding gold)	10:1	Consistent with limits set by ESMA and FCA. There are no obvious commodity limits within our region for comparison.
Gold	20:1	We have distinguished gold from other commodities due to its different volatility profile, which is similar to sovereign currencies. Our proposal is consistent with limits set by ESMA and FCA.

Underlying asset category	Leverage ratio limit	Rationale and international comparisons
Crypto-assets	2:1	<p>Our proposed leverage ratio limit is restrictive due to the highly volatile nature and immaturity of crypto-assets and is consistent with ESMA and FCA.</p> <p>The crypto-asset market is characterised by a notable lack of liquidity, extreme volatility and an inefficient price discovery process. It also means that crypto-asset CFDs are highly speculative and it is difficult for retail clients to make informed investment decisions.</p>
Equities and all other assets	5:1	Our equities leverage ratio limit is based on ASIC simulations on Australian equities (see Appendix 2, Figure 9). Like ESMA and FCA, the 5:1 leverage ratio applies to any other underlying assets not described in this table.

### Condition 2: Margin close out protection

- 182 This condition standardises the common market practice of automatic margin close-out to ensure consistent and fair application to all retail clients.
- 183 This condition is intended to reduce consumer detriment by limiting retail client losses to around 50% of their investment (compared to current market practice, which we have observed can be up to 90%). This protects retail clients from excessive losses in their CFD positions from unexpected sudden changes in the price of underlying assets: see paragraphs 109–114.
- 184 The CFD issuer must do all things necessary to ensure that it acts efficiently, honestly and fairly in closing out open CFDs: see s912A(1)(a) of the Corporations Act.
- 185 This condition is consistent with measures introduced by ESMA: see paragraph 130.

### Condition 3: Negative balance protection

- 186 There is a risk with leveraged CFDs that retail clients may lose more than their investment, resulting in them owing a debt. Some retail clients do not understand this risk. Such losses and debt can lead to significant distress and hardship for retail clients: see paragraph 66.
- 187 This condition protects retail clients from negative balances. Some CFD issuers already offer this protection and this condition standardises that expectation to ensure consistent and fair treatment to all retail clients.
- 188 Following ESMA's intervention, the value of retail client debt that was forgiven by firms in the United Kingdom due to negative balance protection between August and October 2018 was £1.45 million, equal to a projected benefit of £5.8 million annually: see FCA [CP18/38](#) (PDF 1001 KB) at paragraph 3.51.

189 This condition is consistent with Measure 3 ‘Negative balance protection’ of the [IOSCO toolkit](#) (PDF 988 KB) (see Table 2), and with measures introduced by ESMA: see paragraph 130.

#### **Condition 4: Prohibition on inducements**

190 This condition aims to address inappropriate marketing strategies and inducements, such as gifts, rebates, trading credits or rewards that encourage retail clients to trade more frequently or to refer other retail clients to trade in CFDs: see paragraphs 59–63. They can attract inexperienced retail clients that may not understand the products and distract them from the high-risk nature of the products.

191 This condition is consistent with Measure 8 ‘A ban on restrictions on certain forms of marketing or sales techniques for relevant products’ of the [IOSCO toolkit](#) (PDF 988 KB) (see Table 2), and with measures introduced by ESMA: see paragraph 130.

#### **Conditions 5–8**

192 In complying with Conditions 5–8 we expect CFD issuers to present important information about CFD trading in a way that minimises retail client confusion.

##### *Condition 5: Risk warnings*

193 This condition requires CFD issuers to draw retail clients’ attention to the risk of losing money trading CFDs by affixing risk warnings to all account opening forms, PDSs, any trading platforms maintained by the CFD issuer and websites.

194 We propose to allow CFD issuers three months from the day the order is registered to display the risk warnings to retail clients on trading platforms.

195 This condition is consistent with Measure 5 ‘Disclosure of investor profit and loss ratio’ of the [IOSCO toolkit](#) (PDF 988 KB) (see Table 2), and with measures introduced by ESMA (see paragraph 130).

##### *Condition 6: Real-time disclosure of total position size*

196 Many retail clients do not have a clear idea of the total size of their CFD positions when trading CFDs with high leverage (e.g. at 500:1, a \$5,000 margin investment provides a \$2.5 million CFD exposure). Many CFD issuers only display margins, funds available and profit and loss on their trading platforms, and not the total position size.

197 Not providing retail clients with access to information about their total position size contributes to retail client confusion about risks and increases

retail clients' propensity to place larger trades (unknowingly) and/or trade more often.

198 This condition addresses concerns identified in our surveillance activities. If implemented, to our knowledge, Australia will be the first jurisdiction to implement a product intervention measure of this nature.

199 We propose to allow CFD issuers three months from the day the order is registered to display total position size to retail clients on trading platforms.

*Condition 7: Real-time disclosure of overnight funding costs*

200 Some CFD issuers charge very high annualised overnight funding costs on certain contracts. Added to this, the high costs are often not prominently disclosed or are occasionally disclosed as a daily rate to obscure the high annualised rate. These charges may be disproportionate to common benchmark interest rates and are not well understood by retail clients.

201 As such, overnight funding costs can contribute to a fast decay of clients' margin balances, even in the absence of trading losses: see paragraphs 117–118.

202 This condition requires a CFD issuer to display on any trading platforms maintained by the CFD issuer both an estimate of the annualised rate of interest charged and the corresponding estimated cost, calculated in real-time and expressed in the currency denomination of the CFD.

203 This condition also addresses concerns identified in our surveillance activities. If implemented, to our knowledge, Australia will be the first jurisdiction to implement a product intervention measure of this nature.

204 We propose to allow CFD issuers three months from the day the order is registered to display estimates of overnight funding costs and annualised rates to retail clients on trading platforms.

*Condition 8: Transparent pricing and execution*

205 Most CFD issuers adopt a degree of discretion in price setting, which is particularly apparent during periods of high market volatility.

206 There is a general expectation among retail clients that market forces will cause prices quoted by CFD issuers to closely mirror movements on the relevant reference markets, though this is not readily verifiable as there is opacity surrounding CFD issuers' price-setting methodology.

207 As a result, even with access to real-time data on an underlying asset, retail clients can be sold products that are misaligned with their needs, expectations and understanding.

- 208 Each year we receive a large number of complaints from retail clients about CFD pricing and execution—for example, complaints that the CFD issuer unfairly exercised a discretion to close out CFD positions and that CFD prices were not determined fairly by the CFD issuer.
- 209 The condition requires a CFD issuer to clearly explain how it determines its CFD prices, including how it uses independent and externally verifiable price sources and applies any spread or mark-up. An issuer must also explain any circumstances under which its CFD prices will vary from the pricing methodology.
- 210 The condition also requires an issuer to clearly explain how the CFD issuer deals with clients' offers to trade CFDs and effects CFD trades. The execution policy must, among other things, include a summary of the arrangements the CFD issuer has in place to ensure that the CFD issuer deals with clients' offers and issues and terminates CFDs efficiently, honestly and fairly.
- 211 We propose to allow CFD issuers three months from the day the order is registered to make their pricing methodology and execution policy available to retail clients.
- 212 This condition is consistent with Measure 6 'Adoption of a fair pricing methodology and use of externally verifiable price sources' and Measure 7 'Enhanced disclosures about order execution quality' of the [IOSCO toolkit](#) (PDF 988 KB): see Table 2.

### **Competition effects**

- 213 If our proposed intervention is implemented, CFDs will continue to be available for acquisition by retail clients with enhanced consumer protections in place to reduce harm suffered by retail clients and to minimise retail client confusion. This means that retail clients will continue to have access to these products which they can use for trading, investment or risk management purposes.
- 214 Some retail clients may perceive our proposed leverage ratio limits as a restriction on their consumer choice, in particular their ability to gain large exposures. On balance, our view is that the reduction in retail client detriment that our proposed intervention will provide outweighs these concerns.
- 215 Another benefit of imposing market-wide conditions is that it applies to all issuers of CFDs equally. It will set an even bar among all CFD issuers and provide consistency with measures introduced overseas.
- 216 Our proposed intervention is likely to impact on issuers' revenue, and disproportionately more for CFD issuers that currently offer higher leverage ratios. A component of revenue lost by CFD issuers would be losses avoided by retail clients.

## G Regulatory and financial impact

217 In developing the proposals in this paper, we have carefully considered their regulatory and financial impact. On the information currently available to us we think they will strike an appropriate balance between:

- (a) reducing the nature, likelihood and extent of the significant consumer detriment resulting from binary options and CFDs issued in or from Australia;
- (b) the financial and other impact of the proposed orders on issuers of binary options and CFDs; and
- (c) any effects on competition in the Australian financial system.

218 Before settling on a final policy, we will comply with the Australian Government's regulatory impact analysis (RIA) requirements by:

- (a) considering all feasible options, including examining the likely impacts of the range of alternative options which could meet our policy objectives;
- (b) if regulatory options are under consideration, notifying the Office of Best Practice Regulation (OBPR); and
- (c) if our proposed option has more than minor or machinery impact on business or the not-for-profit sector, preparing a Regulation Impact Statement (RIS).

219 All RISs are submitted to the OBPR for approval before we make any final decision. Without an approved RIS, ASIC is unable to give relief or make any other form of regulation, including issuing a regulatory guide that contains regulation.

220 To ensure that we are in a position to properly complete any required RIS, please give us as much information as you can about our proposals or any alternative approaches, including:

- (a) our identification of the products and their availability for acquisition by issue to retail clients;
- (b) the significant consumer detriment we have identified;
- (c) the product intervention orders we propose to make;
- (d) the likely compliance costs;
- (e) the likely effect on competition; and
- (f) other impacts, costs and benefits.

See 'The consultation process' on page 4.

## Appendix 1: ASIC's actions in the retail OTC derivatives sector

### Enforcement actions

- 221 We have taken strong enforcement action in response to misconduct in connection with binary options and CFDs. Recent examples include:
- (a) obtaining *ex parte* interim orders in the Federal Court against Forex Capital Trading Pty Ltd that restrained the company from removing their assets, including client money, from Australia. In May 2019 the Federal Court extended and amended the orders by consent of the parties to 30 September 2019 (see [Media Release \(19-062MR\)](#) *ASIC obtains interim injunctions against Forex Capital Trading* (21 March 2019));
  - (b) cancelling the AFS licence for Berndale Capital Securities Pty Ltd (Berndale) and banning a former director (see [Media Release \(18-363MR\)](#) *ASIC cancels retail OTC derivative issuer Berndale Capital Securities licence and bans former director* (30 November 2018));
  - (c) successfully applying for the appointment of a receiver to Berndale and two related companies due to concerns about client money handling practices (see [Media Release \(19-100MR\)](#) *ASIC succeeds in application to appoint a receiver to former OTC derivatives issuer Berndale Capital Securities Pty Ltd* (26 April 2019));
  - (d) cancelling the AFS licence held by AGM Markets Pty Ltd (AGM Markets) for unconscionable conduct and unmanaged conflicts of interest (see [Media Release \(18-340MR\)](#) *ASIC cancels AGM Markets licence for unconscionable conduct and unmanaged conflicts of interest* (9 November 2018)) and banning a former director (see [Media Release \(18-347MR\)](#) *ASIC bans former director of AGM Markets from providing financial services for 8 years* (19 November 2018));
  - (e) cancelling the AFS licence held by Direct FX Trading Pty Ltd for serious compliance failures (see [Media Release \(18-315MR\)](#) *ASIC cancels AFS licence of retail OTC derivative issuer Direct FX Trading Pty Ltd for serious compliance failures* (18 October 2018));
  - (f) accepting a court enforceable undertaking from Vantage Global Prime Pty Limited to address inadequate systems and controls in its CFD business (see [Media Release \(18-190MR\)](#) *ASIC calls on retail OTC derivatives sector to improve practices* (28 June 2018)); and
  - (g) permanently banning Jana Jaros and Jackson Laurence Malcom Capper from providing financial services or from engaging in any credit activities (see [Media Release \(18-034MR\)](#) *Operators of 'binary options*

*trading boiler room' banned following conviction (8 February 2018)), after they were convicted of operating a binary options trading 'boiler room' (see [Media Release \(17-378MR\)](#) Operators of 'binary options trading boiler room' convicted and sentenced (9 November 2017)).*

## Public warning notices and other statements

- 222 We have made numerous public statements (including media releases and public warning notices) to highlight misconduct in connection with binary options and CFDs and the risks to retail clients, including:
- (a) a media release warning that some AFS licensees may be breaking overseas laws (see [Media Release \(19-088MR\)](#) *Some AFS licensees may be breaking overseas laws* (11 April 2019));
  - (b) a media release highlighting our findings in REP 579 (see [Media Release \(18-190MR\)](#) *ASIC calls on retail OTC derivatives sector to improve practices* (28 June 2018));
  - (c) a media release warning the public not to deal with AGM Markets and two of its authorised representatives (see [Media Release \(18-036MR\)](#) *ASIC obtains interim injunctions and warns investors against AGM Markets, OT Markets and Ozifin (Trade Financial)* (13 February 2018));
  - (d) a public warning notice in relation to Titantrade.com which is a website offering binary options (see [Media Release \(16-246MR\)](#) *ASIC warns investors about Titantrade.com* (4 August 2016) and [PWN 2016-4](#) (PDF 65 KB));
  - (e) a media release highlighting our findings in REP 482 (see [Media Release \(16-197MR\)](#) *ASIC releases report highlighting significant failures in the retail OTC derivatives industry* (20 June 2016));
  - (f) a media release with further references to REP 482 and warning retail clients of unlicensed conduct by retail OTC derivatives providers (see [Media Release \(16-218MR\)](#) *ASIC crackdown on unlicensed retail OTC derivative providers* (6 July 2016));
  - (g) a media release stating that retail OTC derivatives issuer XTrade.au Pty Ltd will implement changes to its client money handling practices, in response to ASIC's intervention (see [Media Release \(16-213MR\)](#) *XTrade to change client money practices following ASIC surveillance* (1 July 2016));
  - (h) a public warning notice in relation to various unlicensed binary options providers (see [Media Release \(16-189MR\)](#) *ASIC warns investors about dealing with GOptions, Porterfinance, Boss Capital, MaxOptions, Bloombex Options, Citrades, RBOptions and OptionsXO* (9 June 2016) and [PWN 2016-3](#) (PDF 99 KB));

- (i) a public warning notice in relation to the ‘Top Ten Binary Brokers’ website (see [Media Release \(16-142MR\)](#) *ASIC warns investors about services advertised by Top Ten Binary Brokers also known as Top 10 Binary brokers.com (Top Ten Binary Brokers)* (16 May 2016) and [PWN 2016-2](#) (PDF 112 KB)); and
- (j) a public warning notice in relation to Market City International and Brokers500 (see [Media Release \(16-066MR\)](#) *ASIC warns investors about dealing with Market City International and Brokers500* (8 March 2016) and [PWN 2016-1](#) (PDF 318KB)).

Note: Under s12GLC of the *Australian Securities and Investments Commission Act 2001*, ASIC may, in specific circumstances, issue to the public a written notice (i.e. a public warning notice) containing a warning about the conduct of a person.

## Stronger regulations

### Enhanced protections for client money

- 223 In early 2017 the Australian Parliament passed the Treasury Laws Amendment (2016 Measures No. 1) Bill 2016 and the Corporations Amendment (Client Money) Regulations 2017. These legislative reforms removed several broad exceptions in the Corporations Act that permitted retail OTC derivatives issuers to use client money for a wide range of purposes, including as the issuer’s own working capital.
- 224 Following these reforms, we made the ASIC Client Money Reporting Rules 2017 which commenced on 4 April 2018. We also amended our guidance in [Regulatory Guide 212](#) *Client money relating to dealing in OTC derivatives* (RG 212) and released [Information Sheet 226](#) *Complying with the ASIC Client Money Reporting Rules 2017* (INFO 226). The rules impose record-keeping, reconciliation and reporting obligations on AFS licensees that hold ‘derivative retail client money’. The rules apply more formal and consistent standards across the retail OTC derivatives sector and ensure greater transparency about the use of derivative retail client money (including to inform ASIC’s surveillance activities).

### Ensuring adequate financial resources

- 225 In August 2012 we amended the AFS licence financial resource requirements for retail OTC derivatives issuers. These changes were made to help ensure that retail OTC derivatives issuers have sufficient financial resources to operate their business in a compliant manner.

## Education campaigns and guidance

- 226 Over the past 10 years we have implemented a range of regulatory strategies to educate retail clients on the nature and risks of trading binary options and CFDs, and to improve issuers' compliance standards. This has included the publication of reports, regulatory guides and educational material. Table 7 sets out our key publications.
- 227 Our most recent campaign on binary options, [Binary options trading—watch this video before you trade](#), was widely promoted through social media channels. This video reached 82,464 views from its social media post from 3–8 June 2018.

**Table 7: Summary of ASIC publications and surveillance**

Regulatory document	Purpose
MoneySmart video, <a href="#">Binary options trading—watch this before you trade</a> .	Social media campaign likening the trading of binary options to gambling.
<a href="#">Media Release (17-257MR)</a> <i>ASIC targets unlicensed binary option mobile apps</i> (1 August 2017)	We conducted a review of mobile app stores focusing on apps with binary options trading that were offered to Australian consumers by unlicensed entities.
<a href="#">Report 579</a> <i>Improving practices in the retail OTC derivatives sector</i> (REP 579): see also <a href="#">18-190MR</a>	REP 579 sets out the key findings of our 2017 review: see paragraph 44
<a href="#">Information Sheet 226</a> <i>Complying with the ASIC Client Money Reporting Rules 2017</i> (INFO 226)	INFO 226 provides information to help AFS licensees to comply with their obligations under the ASIC Client Money Reporting Rules 2017: see paragraph 226.
<a href="#">Report 482</a> <i>Compliance review of the retail OTC derivatives sector</i> (REP 482): see also <a href="#">16-197MR</a> and <a href="#">16-218MR</a>	REP 482 sets out the findings from our 2015 compliance review.
<a href="#">Report 316</a> <i>Review of client money handling practices in the retail OTC derivatives sector</i> (REP 316)	REP 316 sets out our observations of the client money handling practices of issuers of CFDs to retail clients between December 2011 and August 2012.
MoneySmart video, <a href="#">What are contracts for difference?</a>	A short educational video explaining CFDs, how they are traded and their risks.
MoneySmart investor guide, <a href="#">Thinking of trading contracts for difference (CFDs)?</a> (PDF 646 KB)	This guide was part of our client education campaign in March 2012 to warn retail clients of the risks posed by CFDs and misconduct in this sector.
<a href="#">Regulatory Guide 227</a> <i>Over-the-counter contracts for difference: Improving disclosure for retail investors</i> (RG 227)	RG 227 aims to improve disclosure documents so they contain all the information that retail clients require to make an informed investment decision.

Regulatory document	Purpose
<a href="#">Report 205</a> <i>Contracts for difference and retail investors</i> (REP 205)	REP 205 presents our findings of a 'health check' of the CFD market. We found the complex structure of CFDs and the risks associated with them mean that they are unlikely to meet the investment needs, objectives and risk profile of many retail clients.
<a href="#">Regulatory Guide 212</a> <i>Client money relating to dealing in OTC derivatives</i> (RG 212)	RG 212 provides guidance to retail OTC derivatives issuers on their client money obligations under Div 2 of Pt 7.8 of the Corporations Act. It also seeks better disclosure of client money related matters.

## Appendix 2: Analysis on setting leverage ratio limits

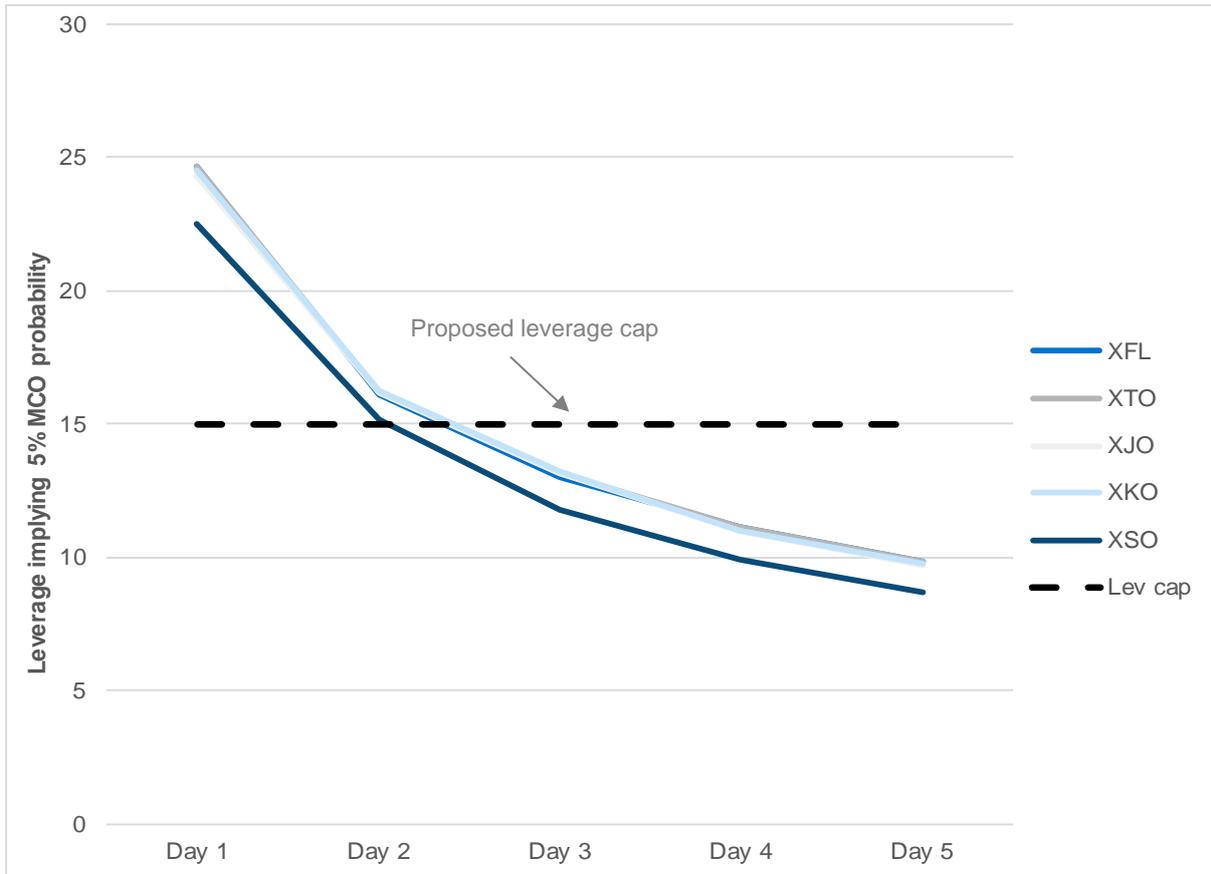
### ESMA's simulations

- 228 As part of its analysis, ESMA undertook a simulation of the distribution of returns that a retail client trading in a single stock CFD might expect to receive, at different leverage ratio limits.
- 229 ESMA used the probability of an automatic margin close-out as a measure of retail client detriment, and simulated leverage ratio limits that would deliver a 5% probability of margin close-out.
- Note: See ESMA, [Product intervention analysis: measures on contracts for difference](#) (PDF 1.26 MB), 1 June 2018, ESMA50-162-215.
- 230 ESMA conducted similar simulations to inform their leverage ratio limits for different underlying asset classes.

### Australian market simulations

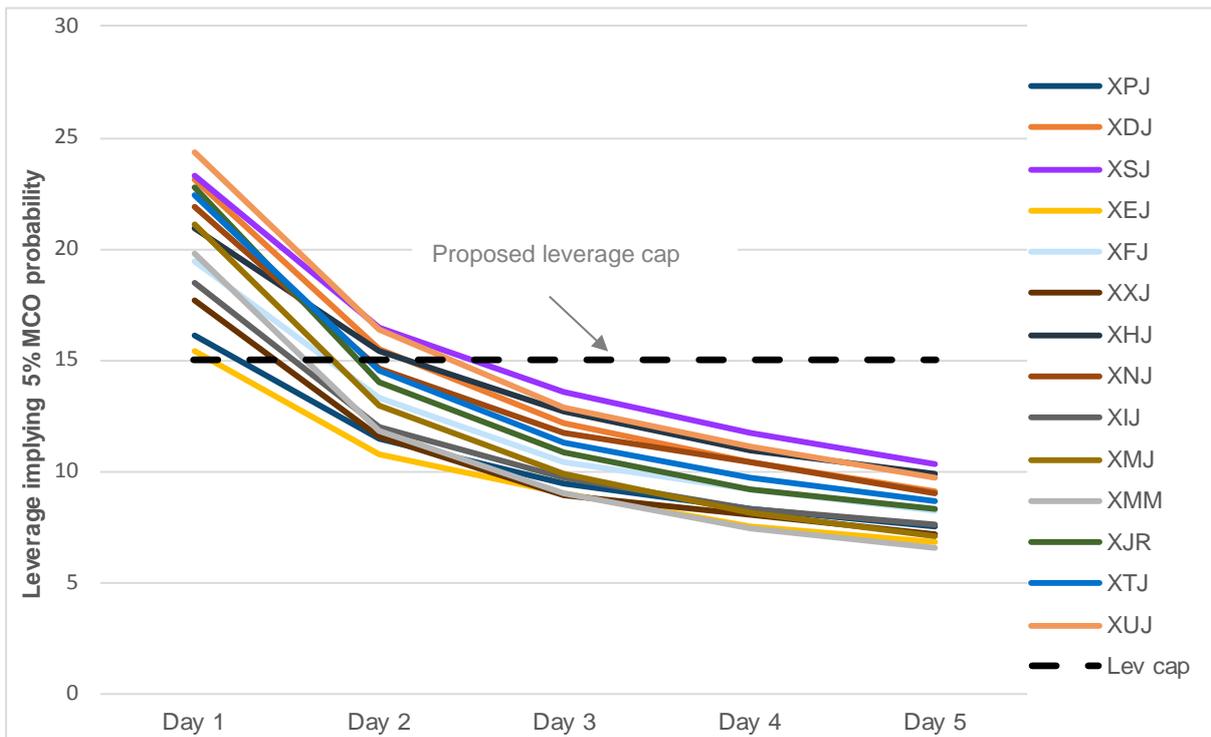
- 231 Given the global nature of the underlying products in ESMA's simulation, we consider its application can be generally extended to CFDs available to retail clients in Australia. To supplement and validate ESMA's analysis, ASIC conducted simulations specifically focusing on the Australian equities market during the past 10 years. This included samples of:
- (a) Australian major equity indices;
  - (b) Australian minor equity indices; and
  - (c) a selection of Australian equities.
- 232 Figure 7 – Figure 9 show the results of our simulation (note that the methodology is based on ESMA's exclusion of fees and costs). In each graph, the vertical axis shows the relevant leverage ratio limits implying a 5% probability of margin close-out and the horizontal axis shows the number of days the position is open (i.e. Day 1 – Day 5). The simulation demonstrated how likely margin close-out is to happen at different leverage ratio limits.
- 233 The figures show the corridor of leverage across a given asset class, for a 5% probability of margin close-out, for different holding periods. On each graph our proposed leverage ratio limits are represented by the dotted horizontal line. This corridor is intended to provide an indication of where a reasonable level of leverage for retail clients may be (e.g. where most reference assets within the class do not experience a 5% margin close-out intraday).

**Figure 7: Leverage limits for CFDs with a sample of main indices as the underlying asset**



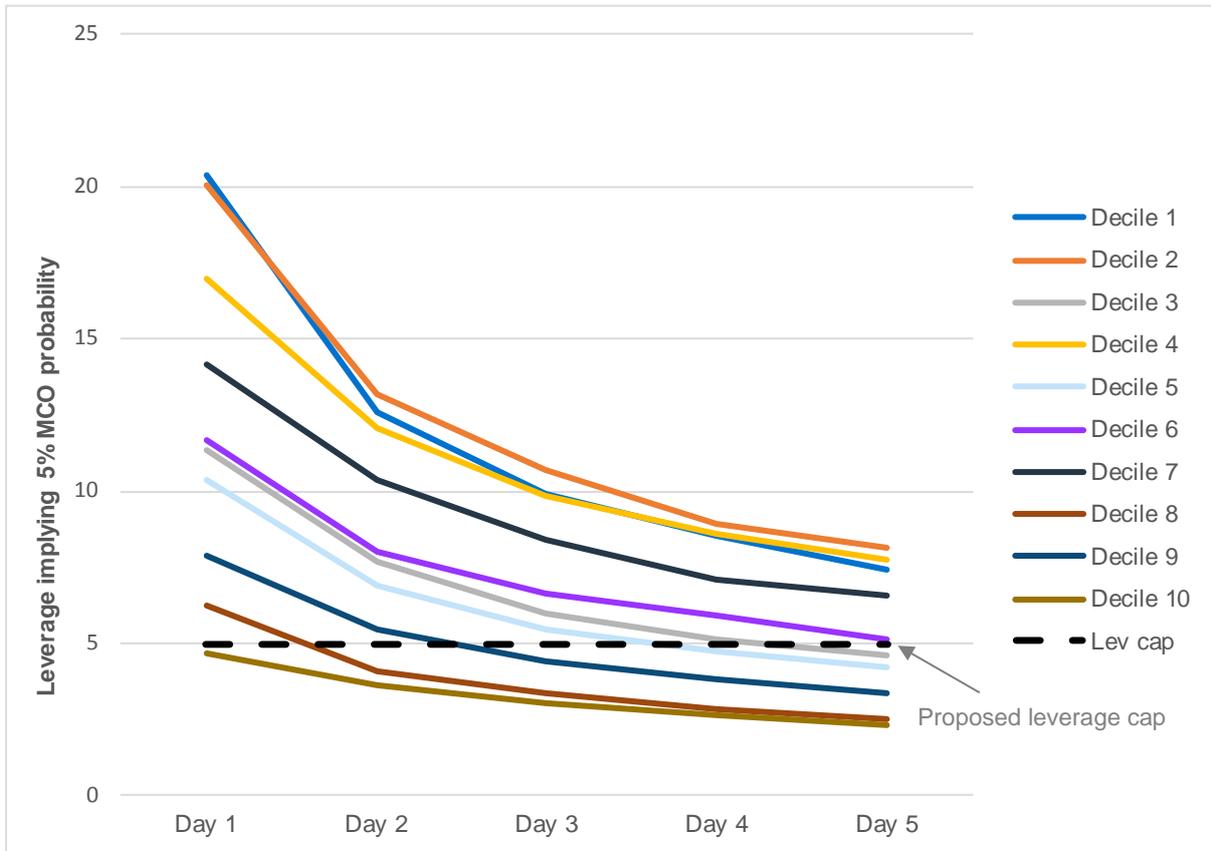
Note: See Table 9 for the data shown in this figure (accessible version).

**Figure 8: Leverage limits for CFDs with a sample of sector indices as the underlying asset**



Note: See Table 10 for the data shown in this figure (accessible version).

**Figure 9: Leverage limits for CFDs with a sample of individual stocks (by market capitalisation decile) as the underlying asset**



Note: See Table 11 for the data shown in this figure (accessible version).

## Appendix 3: Accessible versions of figures

234 This appendix is for people with visual or other impairments. It provides the underlying data for the figures in this report.

**Table 8: Number of complaints to ASIC and AFCA about retail OTC derivatives (2015–2019)**

Year	Complaints to ASIC	Complaints to AFCA
2015	455	70
2016	339	77
2017	382	156
2018	902	434
2019	3,039	748

Note: This data is contained in Figure 5.

**Table 9: Leverage limits for CFDs with a sample of main indices as the underlying asset**

Index	Day 1	Day 2	Day 3	Day 4	Day 5
XFL	24.7	16.1	13.0	11.1	9.8
XTO	24.6	16.2	13.1	11.1	9.9
XJO	24.3	16.2	13.2	11.0	9.7
XKO	24.6	16.2	13.2	11.0	9.8
XSO	22.5	15.2	11.8	9.9	8.7

Note 1: The proposed leverage ratio limit is 15:1.

Note 2: This is the data contained in Figure 7

**Table 10: Leverage limits for CFDs with a sample of sector indices as the underlying asset**

Index	Day 1	Day 2	Day 3	Day 4	Day 5
XPJ	16.1	11.5	9.5	8.3	7.5
XDJ	23.1	15.5	12.2	10.5	9.1

Index	Day 1	Day 2	Day 3	Day 4	Day 5
XSJ	23.3	16.5	13.6	11.8	10.4
XEJ	15.4	10.8	9.0	7.5	6.8
XFJ	19.5	13.3	10.4	9.2	8.2
XXJ	17.7	11.5	9.0	8.0	7.2
XHJ	20.9	15.4	12.7	10.9	9.9
XNJ	21.9	14.6	11.8	10.4	9.0
XIJ	18.5	12.0	9.7	8.4	7.6
XMJ	21.1	13.0	9.9	8.1	7.1
XMM	19.8	11.8	9.0	7.4	6.6
XJR	22.8	14.0	10.9	9.2	8.3
XTJ	22.4	14.5	11.3	9.7	8.7
XUJ	24.4	16.4	12.8	11.1	9.7

Note 1: The proposed leverage ratio limit is 15:1.

Note 2: This is the data contained in Figure 8.

**Table 11: Leverage limits for CFDs with a sample of individual stocks (by market capitalisation decile) as the underlying asset**

Decile	Day 1	Day 2	Day 3	Day 4	Day 5
Decile 1	20.4	12.6	9.9	8.5	7.4
Decile 2	20.0	13.2	10.7	8.9	8.1
Decile 3	11.3	7.7	6.0	5.2	4.6
Decile 4	16.9	12.0	9.9	8.6	7.7
Decile 5	10.3	6.9	5.5	4.7	4.2
Decile 6	11.7	8.0	6.6	5.9	5.2
Decile 7	14.1	10.3	8.4	7.1	6.6
Decile 8	6.2	4.1	3.3	2.8	2.5
Decile 9	7.9	5.4	4.4	3.8	3.4
Decile 10	4.7	3.6	3.1	2.6	2.3

Note 1: The proposed leverage ratio limit is 5:1.

Note 2: This is the data contained in Figure 9.

## Key terms

Term	Meaning in this document
AFCA	Australian Financial Complaints Authority
AFS licence	An Australian financial services licence under s913B of the Corporations Act that authorises a person who carries on a financial services business to provide financial services  Note: This is a definition contained in s761A.
AFS licensee	A person who holds an AFS licence under s913B of the Corporations Act  Note: This is a definition contained in s761A.
ASIC	Australian Securities and Investments Commission
binary option	OTC derivatives that allow clients to make 'all-or-nothing' bets on the occurrence or non-occurrence of a specified event in a defined timeframe
CFD	Leveraged OTC derivatives that allow clients to speculate on the change in value of an underlying asset
CFTC	US Commodity Futures Trading Commission
CONSOB	Italian Commissione Nazionale per le Società e la Borsa
Corporations Act	<i>Corporations Act 2001</i> , including regulations made for the purposes of that Act
CP 313 (for example)	An ASIC consultation paper (in this example numbered 313)
CSA	Canadian Securities Administrators
CySEC	Cyprus Securities and Exchange Commission
ESMA	European Securities and Markets Authority
ETF	Exchange traded funds
expected return	The average of the probability distribution of all possible returns on an investment.
FCA	UK Financial Conduct Authority
FSS	South Korean Financial Supervisory Service
IIROC	Investment Industry Regulatory Organization of Canada
INFO 226 (for example)	An ASIC information sheet (in this example numbered 226)
IOSCO	International Organization of Securities Commissions

Term	Meaning in this document
issuer	An AFS licensee who is authorised to carry on a business of issuing and making a market for binary options and/or CFDs (as the case may be) to retail clients.  Note: 'Issuer' where used in this paper does not include a retail client who is a counterparty to a CFD or binary option (cf. s761E).
KNF	Polish Komisja Nadzoru Finansowego
margin call	A request by a CFD issuer for a client to deposit additional funds into the relevant CFD account when the account balance is below a certain margin requirement
negative expected return	When the expected return calculated from the probability of possible returns is negative (i.e. the client is expected to make a loss on an investment)
OTC	'Over the counter', in relation to a derivative, means a derivative between two counterparties that is not able to be traded on an exchange
product intervention order	An order made under s1023D(1) or (3) of the Corporations Act
Pt 7.9A (for example)	A part of the Corporations Act (in this example numbered 7.9A)
referrer	A third party that refers potential new clients to an issuer and in turn commonly receives some form of remuneration from that issuer. Referrers may include authorised representatives, affiliates, introducing brokers or existing retail clients
REP 579 (for example)	An ASIC report (in this example numbered 579)
retail client	Has the same meaning as defined in s761A of the Corporations Act
retail OTC derivatives	OTC derivatives that are available for acquisition by issue to retail clients, and includes binary options and CFDs
RG 212 (for example)	An ASIC regulatory guide (in this example numbered 212)
s1023F (for example)	A section of the Corporations Act (in this example numbered 1023F)

## List of proposals and questions

Proposal	Your feedback
<p>E1 We propose to exercise our product intervention powers in Pt 7.9 of the Corporations Act to make a market-wide product intervention order, in force for 18 months, which prohibits the issue and distribution of binary options to retail clients and requires that existing retail clients are notified of the terms of the order. We propose that the product intervention would take effect 10 business days after the day on which the legislative instrument is registered.</p> <p>See the draft market-wide product intervention order relating to binary options in Attachment 1 (on our website under <a href="#">CP 322</a>).</p>	<p>E1Q1 Do you agree with our proposal to make a market-wide product intervention order which prohibits the issue and distribution of binary options to retail clients? If not, why not? If you disagree that binary options 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.</p> <p>E1Q2 Do you agree with our proposal that the order would remain in force for a period of 18 months? If not, why not?</p> <p>E1Q3 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?</p> <p>E1Q4 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?</p>

Proposal	Your feedback
<p>F1 We propose to exercise our product intervention powers in Pt 7.9 of the Corporations Act to make a market-wide product intervention order, in force for 18 months, which imposes Conditions 1–8 (set out in Table 5) on the issue and distribution of CFDs to retail clients and requires that existing retail clients are notified of the terms of the order. The order and Conditions 1, 3, 4 and 5 (except trading platform risk warnings) will take effect 20 business days after the day on which the legislative instrument is registered. All other conditions will take effect three months after the day on which the legislative instrument is registered.</p> <p>See the draft market-wide product intervention order relating to CFDs in Attachment 2 (on our website under <a href="#">CP 322</a>).</p>	<p>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.</p> <p>F1Q2 Condition 2 would require the terms of a CFD to provide that a CFD issuer must close out <b>one or more</b> 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 <b>all</b> of the retail client's open CFD positions?</p> <p>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?</p> <p>F1Q4 Do you agree with our proposal that the order would remain in force for a period of 18 months? If not, why not?</p> <p>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?</p> <p>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?</p>