



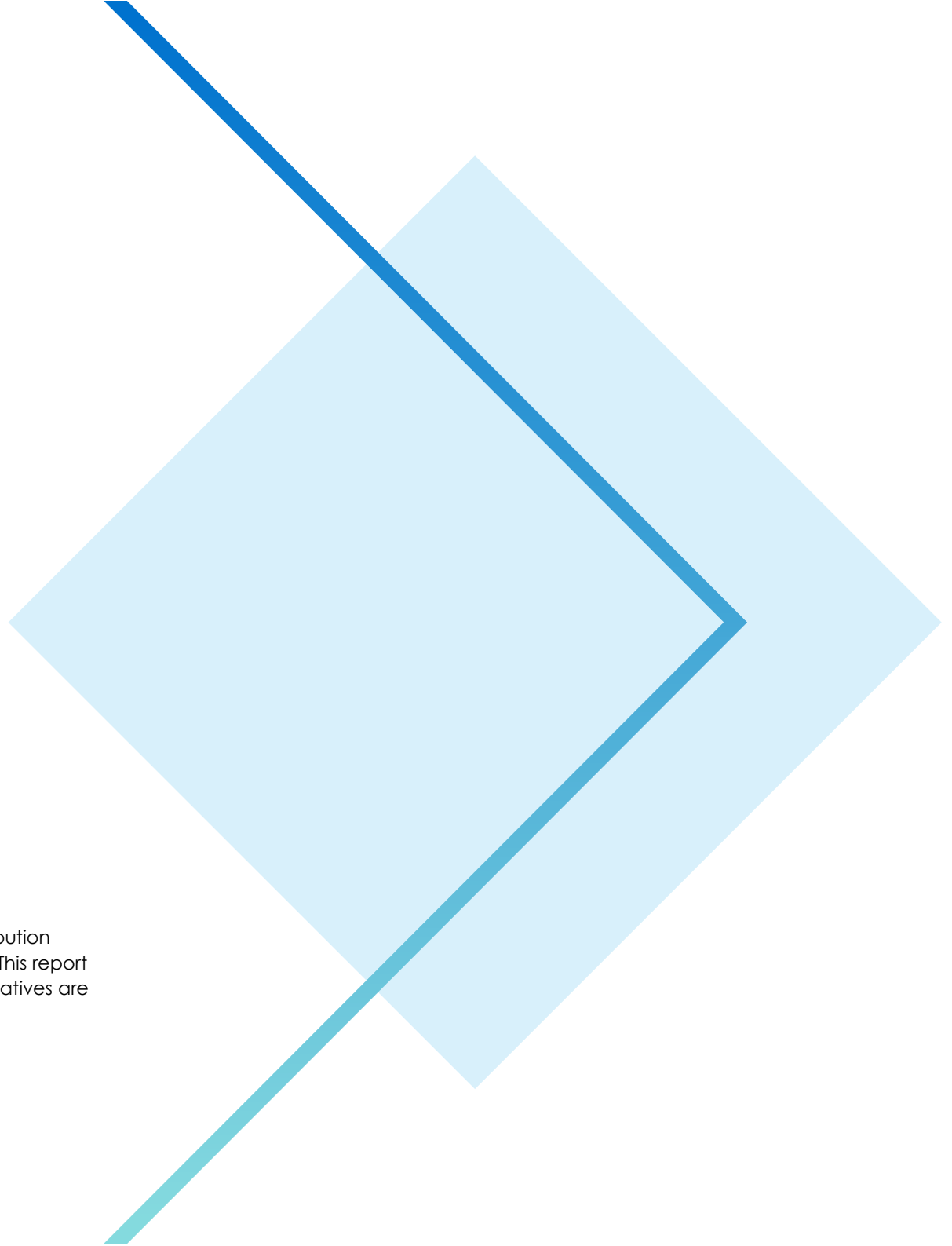
ASIC
Australian Securities &
Investments Commission

Design and distribution obligations: Retail OTC derivatives

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About this report

In 2022–2023, we reviewed compliance with the design and distribution obligations by issuers of retail over-the-counter (OTC) derivatives. This report summarises our key observations on how issuers of retail OTC derivatives are meeting these obligations and highlights areas for improvement.



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Executive summary

For many years, ASIC has taken strong and frequent regulatory action to address consumer harms from offers of over-the-counter (OTC) derivatives to retail clients, including enforcement actions, product intervention orders, public warnings, strengthened financial resource requirements, publications and regulatory guidance.

We recently conducted a targeted review of compliance with the design and distribution obligations by issuers of OTC derivatives to retail clients, including contracts for difference (CFDs), crypto derivatives and novel derivative arrangements. Over 60 Australian financial services licensees offer complex, high-risk OTC derivatives to retail clients in Australia.

This report sets out our findings from the review, with practical observations for issuers and distributors of retail OTC derivatives and other financial products to consider when reviewing their product governance arrangements. It builds on previous reports issued by ASIC on compliance with the design and distribution obligations, including [Report 754 Target market determinations for small amount credit contracts](#) (REP 754) and [Report 762 Design and distribution obligations: Investment products](#) (REP 762). This report should be read in conjunction with those reports and [Regulatory Guide 274 Product design and distribution obligations](#) (RG 274) which explains our interpretation of the obligations, our expectations for compliance, and our general approach to administering the obligations.

Echoing findings in ASIC's interim review of issuers of investment products ([REP 762](#)), we found several key areas for improvement in some retail OTC derivative issuers' practices for:

- › preparing a target market determination (TMD), including describing a class of retail clients whose likely objectives, financial situation and

needs are met by the complex, high-risk derivatives (the target market). This was a factor in nine interim stop orders relating to retail OTC derivatives and one product was subsequently withdrawn from retail distribution

- › taking 'reasonable steps' that will, or are reasonably likely to, result in the derivatives reaching the retail clients in the target market defined by the issuer, which was a factor in one interim stop order, and
- › monitoring client outcomes to ensure that the TMD and product governance arrangements remain appropriate.

To date, as a result of our review, we have issued 10 interim stop orders and commenced a civil penalty proceeding for alleged breaches of the design and distribution obligations by retail OTC derivative issuers. We have also engaged with other product issuers to achieve changes to products and distribution practices.

Summary of key findings

We have set out findings from our review to provide issuers and distributors of retail OTC derivative and other financial products with practical observations about making a TMD and meeting the reasonable steps and review obligations. In summary, our observations include:

- › **Use of available data**—Some issuers do not use their existing client data, external data sources or other available information to assist them in designing derivative products or objectively assessing whether the product would likely be consistent with the objectives, financial situation and needs of the consumers in the target market. Better practices we observed involved using existing client data to

filter out consumers for whom the product would likely be inappropriate and using clients' profit and loss data (among other data) when reviewing the TMD.

- › **Some TMDs lacked sufficient granularity**—Nearly all of the TMDs we reviewed identified the high-risk nature of OTC derivatives and generally reflected the appropriate risk profiles and consumer characteristics for high-risk products of this kind. However, some TMDs lacked sufficient granularity and needed to use more specific and detailed parameters in describing the target market.
- › **Over-reliance on client questionnaires**—Many retail OTC derivative issuers relied on client questionnaires (some with serious flaws) as a primary filter to determine if consumers were reasonably likely to fall within the target market.
- › **Over-reliance on existing controls**—Many CFD issuers stated reliance on controls developed for meeting disclosure benchmarks in [Regulatory Guide 227](#) *Over-the-counter contracts for difference: Improving disclosure for retail investors* (RG 227) for their compliance with design and distribution obligations: see Appendix 2. Published in 2011, RG 227 and the seven disclosure benchmarks pre-date the design and distribution obligations. The design and distribution obligations move beyond disclosure and require a risk management approach to distribution. Distribution controls based on the guidance in RG 227 alone are unlikely to be sufficient to meet an issuer's obligation to take reasonable steps likely to result in retail distribution conduct being consistent with the TMD.
- › **Marketing practices**—Some issuers engage in mass marketing of OTC derivatives to a broad consumer audience, which in the absence of strong distribution controls may be incompatible with an issuer's narrow target market and obligation to take reasonable steps likely to result in distribution conduct being consistent with the

TMD. Better marketing practices that we observed involved targeted campaigns to specific distribution channels and publications that were likely to reach the target market. Those issuers that took advantage of their existing client data were able to use this information to better focus marketing to an appropriate target market.

- › **Poorly defined TMD review triggers**—We identified several examples of unrealistic or poorly defined review triggers that would not assist an issuer to identify whether its TMD was no longer appropriate.
- › **Leadership engagement needed**—Overall, we thought there could be more engagement by the board and senior leadership of retail OTC derivative issuers with arrangements for complying with the design and distribution obligations.

Our expectations

Issuers and distributors of retail OTC derivatives and other financial products should consider this report when reviewing the controls and processes they have implemented to ensure compliance with the design and distribution obligations. The 'reasonable steps' obligations under the design and distribution obligations require a risk management approach. Issuers need to consider all relevant factors, including the

strengths and weaknesses of their controls and whether together these reduce the risk of the product being distributed in a way that is inconsistent with the TMD for the product.

Our regulatory actions

The design and distribution obligations remain a key focus for ASIC. We will continue to monitor compliance across sectors and we will take regulatory action for breaches of the obligations where appropriate. To date, we have issued 82 interim stop orders under the design and distribution obligations, including the 10 orders relating to retail OTC derivatives. Of the 82 interim stop orders issued, 77 have been lifted following actions taken by the entities to address ASIC's concerns or where the products were withdrawn, and five remain in place.

Further, issuers have subsequently withdrawn 11 products from the market and we have commenced civil penalty proceedings for alleged breaches of the design and distribution obligations against Firstmac Limited, a distributor of a managed investment scheme, American Express Australia Limited, an issuer of a credit product, and eToro Aus Capital Limited, an issuer of CFDs.

Complying with the design and distribution obligations

Purpose and scope of our reviews

Post-implementation survey

In March 2022, we surveyed 16 CFD issuers on their approach to compliance with the design and distribution obligations.

- › Most of the surveyed issuers had adapted their TMDs from industry templates and proposed to review their TMDs within six months of them being made.
- › Only one firm surveyed had changed their product design in preparing to comply with the design and distribution obligations.
- › Around 35% claimed they had revised their marketing, but very few had changed their distribution strategies or methods, or narrowed their target market.

TMD reviews

In late 2022, we undertook a broad review of TMDs for OTC derivatives issued to retail clients. We focused on reviewing TMDs for high-risk OTC derivatives for CFDs, crypto derivatives, options and other novel derivative arrangements.

Targeted compliance reviews

Between November 2022 and February 2023, we selected 11 retail OTC derivative issuers—varying in size, number of retail clients and product type—for a more comprehensive assessment of their product distribution, monitoring and governance arrangements. We selected two other retail OTC derivative issuers for review based on their novel product structures. The purpose of the reviews was to test compliance with the design and distribution obligations and identify better and poorer practices among retail OTC derivative issuers. We gathered information about their:

- › development of TMDs
- › client onboarding process and use of client questionnaires
- › client outcomes, complaints and significant dealings, and
- › governance structures and processes.

In reviewing compliance, we took into account our guidance in [RG 274](#) on developing product governance, distribution and review arrangements to meet the obligations.

Key observations: Making an appropriate TMD

Under the design and distribution obligations, an issuer must prepare a TMD that meets the requirements in s994B(5) and (8) (the 'content' and 'appropriateness' requirements). The TMD must set out an appropriate target market describing the consumers whose likely objectives, financial situation and needs are likely to be met by the product. Appropriate distribution conditions in the TMD must make it likely for consumers who acquire a product to be in the target market.

If using a TMD template, issuers must tailor the template to reflect the features and circumstances of their product, including describing the target market with objective, tangible parameters and with sufficient granularity. This will help the issuer to meet the appropriateness requirements: see [RG 274](#) at RG 274.80–RG 274.86.



Making an appropriate TMD

Most retail OTC derivative products in our review were available for issue both before and after the commencement of the design and distribution obligations in October 2021. For existing products that continue to be issued to consumers, issuers are required to assess the key attributes of those products and the consumer objectives, financial situation and needs for which the product and its key attributes are likely to be appropriate: see [RG 274](#) at RG 274.43.

Areas for improvement consistent with REP 762

Consistent with ASIC's findings in [REP 762](#), we identified the following areas for improvement for making an appropriate TMD:

- › **Not clearly defining a target market**—For example, some issuers included investment objectives in the TMD that were inconsistent with the features and risks of the product, and others included unclear target market criteria that were not described with objective, tangible parameters.
- › **Inappropriate risk profiles being used in the target market**—CFDs are high-risk products which are not appropriate for consumers seeking 'medium risk' products or for 'income' return profiles. We will intervene when issuers get this wrong. Inappropriate risk profiles were a factor in four interim stop orders we issued regarding retail OTC derivatives.
- › **Inappropriate investment allocation**—OTC derivatives are not appropriate for use as a standalone or core component of retail clients' portfolios. This was a factor in eight of the stop orders regarding CFDs due to the volatile and short-term nature of CFDs and potential for capital losses.
- › **Inappropriate intended investment timeframe**—For example, a CFD issuer set out inappropriate investment timeframes in the objectives of the target market that were inconsistent with the characteristics of the product. CFDs are unlikely to be suitable for consumers seeking longer investment timeframes due to the volatility, leverage, potential for capital loss, overnight financing costs and short-term nature of these products.

Further TMD review observations

In our review, we observed the following better practices regarding TMDs:

- › **High-risk nature of derivatives**— Issuers generally described consumers in the target market for the derivatives consistent with the product characteristics and risks. Nearly all issuers described a risk profile for consumers in the target market that reflected the complex, high-risk nature of the OTC derivatives (i.e. a 'high' to 'very high' risk tolerance). Many of the issuers' OTC derivatives carry the risk of retail clients quickly losing all their funds used for trading. Most issuers we reviewed excluded from the target market for their derivatives investors with incompatible investment objectives (e.g. preservation of capital) or financial situation (e.g. consumers who derive income primarily from benefits).
- › **Using available data to identify target market characteristics**—One issuer used their extensive data relating to consumers' trading history and factors identifying potentially vulnerable consumers to inform the design of a new derivative product and identification of an appropriate target market for the product. Other issuers reviewed their existing client trading patterns to identify the timing and types of trades, as well as characteristics of loss-making accounts, to better understand the class of consumers that are likely to be outside the target market for the product. We identified some issuers who used external data sources and academic research to help inform them in setting out the class of consumers in the target market.

Areas for improvement

We identified the following areas for improvement among the issuers of retail OTC derivatives we reviewed:

- › **Target market description based on existing consumers**—Some CFD issuers advised that the development of their TMD was based primarily on describing their existing client base rather than considering whether the product was appropriate for these clients and their likely objectives, financial situation and needs. In one example, an issuer used a template in a 'tick-a-box' way to describe their existing client base, even though that description included consumers for whom the product was not likely to be appropriate (see Case study 1). For continuing products, issuers must critically assess the product and its key attributes to identify the target market by reference to consumers for whom the product is likely to be consistent with their likely objectives, financial situation and needs: see [RG 274](#) at RG 274.43–RG 274.44. This should then be reflected in the issuer's broader product governance arrangements, such as by setting distribution conditions and restrictions in line with the identified target market.
- › **Not changing distribution methods**—Most retail OTC derivative issuers indicated they had not changed their arrangements for distribution of CFDs following the commencement of the design and distribution obligations. Issuers should set distribution conditions in line with their target market, even if this is a narrower cohort than they have previously targeted.
- › **Minimal template customisation**—In some cases, we observed that issuers that did not appear to have appropriately tailored TMDs prepared using templates in a manner that considered the likely

needs, objectives and financial situation of consumers in the target market or described the target market with sufficient granularity or use of objective parameters.

- › **Few updates following TMD reviews**—While most issuers nominated an annual review of the appropriateness of their TMD, we observed that very few issuers appeared to have updated, revised or re-issued their TMD since the design and distribution obligations came into effect on 5 October 2021.

Case study 1: Target market poorly designed to encompass outliers

We observed one CFD issuer who included in its target market retail clients who intended to use CFDs as a standalone or core component of their investment portfolio, retail clients who had an investment timeframe of up to one year or up to three years and retail clients seeking growth or income. We were concerned that the TMDs inappropriately described the target market, given the short-term and volatile nature of the underlying products. We issued interim stop orders after determining that the TMDs were inappropriate, failed to display sufficient granularity and included product characteristics which were not suitable in all cases.

After we intervened, the issuer amended their TMDs to more accurately and narrowly define an appropriate target market for each type of CFD. The stop order was lifted after the issuer satisfactorily addressed our concerns with the TMDs.

Case study 2: Better practice using available data to prepare a TMD

One retail OTC derivative issuer outlined a comprehensive process for developing its TMD which included the use of both qualitative and quantitative data. It reviewed its client history over previous years to identify the type and length of trades being placed, the value of client investments relative to their total portfolio, the number and nature of loss-making accounts and other client profiling factors. The issuer also reviewed academic literature on investor behaviour against their own experiences. From this, the issuer was able to refine its target market further, which enabled a clearly defined and narrow distribution strategy.

Key observations: Distribution consistent with the TMD and reasonable steps

Issuers and distributors must take reasonable steps that will, or are reasonably likely to, result in distribution of a product being consistent with the product's TMD ('reasonable steps' obligations): see s994E(1) and (3). To meet these obligations, issuers and distributors must implement effective arrangements that are likely to direct distribution of the product to the target market: see [RG 274](#) at RG 274.139–RG 274.142, RG 274.167 and RG 274.170.

Retail OTC derivative issuers typically deal directly with consumers, so are both the issuer and a distributor of the derivatives. Some issuers have arrangements with one or more intermediaries who help facilitate the distribution of the product (e.g. by applying for the issue of derivatives on behalf of a consumer or otherwise arranging for a consumer to deal in derivatives with the issuer). Some distribution and marketing methods include comparison sites, affiliate relationship arrangements, copy trading, algorithmic trading and 'gamification' of trading apps (see also 'Marketing' and 'ASIC's ongoing supervisory activities' below).

To meet the 'reasonable steps' obligation, an issuer must consider all aspects of a product's distribution, including the distributors, methods, marketing, controls and supervision. Retail OTC derivative issuers will also need to consider the choice architecture built into the context of the sales process and the presentation of the product within that context: see [RG 274](#) at RG 274.144–RG 274.145.

Building on the factors set out in s994E(5), we have provided guidance on various factors we would consider on whether an issuer or distributor is

meeting their 'reasonable steps' obligations—however, the guidance is not exhaustive: see Table 4 and Table 6 of [RG 274](#). Over-reliance on a single distribution control, such as a client questionnaire, is unlikely to be sufficient for retail OTC derivative issuers to meet their 'reasonable steps' obligations. Given the high-risk nature of these products, retail OTC derivative issuers need to be diligent in ensuring they have effective controls in place to make sure these distribution methods are consistent with directing the distribution of the products to the target market.

In our review, we observed better and poorer practices by retail OTC derivative issuers in their use of: (a) client questionnaires, (b) marketing and (c) offers of inducements and incentives.



Client questionnaires

All the retail OTC derivative issuers we reviewed relied on questionnaires or assessments at the point of sale to assess whether prospective clients were likely to be in the target market for the product.

Before the implementation of the design and distribution obligations, CFD issuers commonly used questionnaires when determining whether a consumer met product knowledge and experience criteria as set out under their written client qualification policy: see [RG 227](#) at RG 227.37.

We were disappointed to find some CFD issuers had made little change to pre-existing distribution arrangements and controls to comply with the design and distribution obligations. Similar to our observations of issuers of

investment products in [REP 762](#), we found an over-reliance by several CFD issuers on client questionnaires in meeting their obligations. Issuers and distributors must adopt a risk management approach and take steps that are reasonably likely to reduce the risk of derivatives being distributed to retail clients in a way that is inconsistent with the TMD: see [RG 274](#) at RG 274.11.

We observed the following better practices in the use of client questionnaires in connection with retail product distribution conduct:

- › **Questionnaires as a final check**—Incorporating client questionnaires at the end of the onboarding process, after the issuer has already applied other filters and mechanisms to constrain applications to their target market, rather than being the primary or only method of assessing whether a consumer is in the target market for the product.
- › **Questions that effectively assess against the target market criteria**—We observed questionnaires that use a range of questions targeted on the TMD criteria to assess whether prospective retail consumers are likely to be in the target market for the product.
- › **'Knock out' questions**—We observed one issuer using 'knock out' questions to immediately exclude clients from the onboarding process, where the responses provided would indicate that the retail client is not likely to be in the target market for the product.
- › **Questions drawn from a pool**—To avoid potential gaming of questionnaires, more rigorous client questionnaires draw a significant number of challenging questions from a large pool of possible questions—one issuer used a pool of 33 questions in their test, another had 50 questions across four categories to draw from.
- › **Lock-out periods**—Multiple issuers implemented a lock-out period for clients to re-attempt the questionnaire if unsuccessful.

- › **Restrictions on unsuccessful attempts**—Many issuers restrict the number of times a prospective client may attempt a client questionnaire and the frequency of attempts within a defined time period.

Areas for improvement

- › **Over-reliance on client questionnaires**—We observed that the majority of issuers rely on a client questionnaire as the sole or key method for distributing derivatives consistently with the TMD and to assess whether a consumer is within their target market. This approach is unlikely to be adequate in meeting the 'reasonable steps' obligation as it places an inappropriate onus on the consumer's answers, is dependent on the quality of the questionnaire itself and potentially ignores other available controls for distribution to be consistent with the TMD. For complex, high-risk products such as CFDs, the likelihood of distribution conduct being inconsistent with the TMD and the significant degree of harm that might result from inconsistent distribution requires issuers to consider the availability of a range of controls to eliminate or minimise the likelihood and harm from inconsistent distribution occurring: see s994E(5) and 'Marketing' below.
- › **Relying on a 'client qualification' policy designed for RG 227 disclosure benchmarks**—In 2011, [RG 227](#) set out guidelines for improved disclosure to retail clients to help them understand CFDs. However, relying on client qualification criteria based on our disclosure guidance in RG 227 is probably insufficient to meet the 'reasonable steps' obligations under the design and distribution obligations. The design and distribution obligations represent a move away from relying primarily on disclosure to

reduce consumer harm and instead require issuers to consider objectively whether a product is likely to be appropriate for the consumers in the target market.

- › **Prompts to change responses**—We saw one issuer’s questionnaire which gave prompts to prospective retail consumers to review any ‘unacceptable answer’ that would indicate that the consumer is not likely to be in the target market for the products or did not meet the issuer’s client qualification criteria. This flaw was a factor in ASIC issuing an interim stop order to the issuer.
- › **Excessive attempts to ‘pass’ the questionnaire**—In one extreme example, we observed an issuer who allowed prospective clients to have unlimited attempts to ‘pass’ its client questionnaire within a 30-day period, even where previous failed attempts would indicate that the client was not likely to be in the target market for the derivatives or meet the issuer’s client qualification criteria. The effectiveness of the questionnaire as a control is undermined in these circumstances. This may increase the likelihood of distribution of OTC derivatives to retail clients that is inconsistent with the TMD, and issuers will need to consider what additional controls can be implemented to manage that risk.
- › **Poorly designed questionnaires**—We observed several issuers whose questionnaires were likely to be ineffective in providing an objective assessment of whether retail clients are likely to be in the target market for the OTC derivatives. In one case, the design of the questionnaire clearly indicated the responses that would satisfy the assessment, undermining its effectiveness. Where there is a narrow target market for a complex, high-risk product, and an issuer observes that their questionnaire only screens out a small proportion of prospective clients, they should consider whether their questionnaire is adequately designed to screen out clients who are unlikely to be in the

target market, especially where they engage in mass marketing.

- › **Self-certification**—Issuers should not ask clients to self-certify that they are in the target market for a product. TMDs are not designed or intended to be provided to retail clients as a disclosure document. Relying on a consumer to self-certify that they are in the target market would be inconsistent with the objectives of the design and distribution regime: see [RG 274](#) at RG 274.178 and Case study 4.

Case study 3: Failure to take other steps

We made an interim stop order against one issuer dealing in CFDs due to it failing to take reasonable steps likely to result in distribution conduct being consistent with the TMD.

We were concerned that the issuer relied on a retail consumer questionnaire with significant flaws as a key step for compliance with its obligations. The questionnaire gave prompts to prospective consumers to review any answers that would indicate they were not in the target market.

We were concerned that the issuer’s steps to reduce the likelihood of distribution conduct being inconsistent with the TMD included inadequate assessment of whether retail investors were likely to be in the target market for the CFDs, in the questionnaire or otherwise.

The interim stop order was lifted once the issuer addressed ASIC’s concerns.

Case study 4: Self-certification

Two retail OTC derivative issuers asked retail clients to self-certify that they were in the target market for the product:

- › **Shifting onus onto consumers**—When design and distribution obligations came into force (5 October 2021), one retail OTC derivative issuer provided all existing clients with a link to its TMD and requested that clients respond if they were not in the target market. As no responses were received, the issuer took the view that they had taken reasonable steps to determine that their clients were within the target market. This is inconsistent with the design and distribution obligations which place the responsibility on the issuer to identify the target market and implement arrangements so that it is likely that the product is distributed to consumers in that target market: see [RG 274](#) at RG 274.6. In May 2023, we reported in [REP 762](#) that distribution conditions requiring self-certification by consumers was a factor in five of the 26 stop order actions taken against issuers of investment products.
- › **Acknowledgements and warranties in the onboarding process**—Another retail OTC derivative issuer required clients to tick an online form confirming they had read and understood their TMD as one of the final steps before the client was able to open a trading account.

While a distributor may fact check a consumer's details with them, they should refrain from requiring the consumer to self-certify that they are in the target market: see [RG 274](#) at RG 274.178.



Marketing

One of the factors we consider relevant when reviewing if an issuer is taking reasonable steps is whether the issuer's promotional materials and marketing campaigns direct distribution towards the target market for the financial product: see Table 4 in [RG 274](#).

Marketing and promotional material should be informed by, and be consistent with, the TMD and may be inappropriate on a mass scale for a product with a narrow target market: see Table 6 in [RG 274](#).

OTC derivatives are complex, high-risk financial products that are not compatible with the objectives, financial situation and needs of most consumers. Mass marketing these products to a wide audience increases the risk of distribution to consumers who are not in the target market for the derivatives, particularly in the absence of strong distribution controls required to filter out consumers for whom the product is likely to be inappropriate.

The better targeted marketing practices that we observed for retail OTC derivative issuers included:

- › **Use of existing data**—One retail OTC derivative issuer made use of existing client data (e.g. age, prior investments, wealth, financial hardship and receipt of benefit payments) to filter out and restrict who received their marketing materials and were eligible to apply for a new product. In this way, the issuer was able to restrict distribution of high-risk OTC derivatives to a narrow part of their total client base who were more likely to be in the target market.

- › **Targeted campaigns**—We observed marketing campaigns that were targeted to specific distribution channels and publications which were likely to reach the target market. One issuer specifically targeted only existing experienced users of CFDs in their marketing, rather than seeking to distribute to new ‘first time’ traders.
- › **Key words and filters**—Several CFD issuers made extensive use of filters and keywords in online marketing campaigns to target consumers in their target market. Some issuers used advertising channels with strict parameters targeting specific audiences. In one example, audiences aged 25 years and younger were specifically excluded from any social media platform advertising campaigns.

Areas for improvement

- › **Mass market advertising campaigns**—Some issuers engaged in mass marketing of OTC derivatives using television commercials, sponsorship of sporting teams, advertising at sporting events and on public transport, and bill-board advertising at busy public places. Likewise, we viewed ‘brand awareness’ campaigns as marketing of OTC derivatives where the issuer did not provide other products and services. Mass marketing of high-risk financial products with a narrowly defined target market may be incompatible with an issuer’s obligation to take reasonable steps likely to result in retail distribution conduct being consistent with the TMD.
- › **Marketing through ‘partner’ campaigns**—Some financial product issuers have undertaken promotions using ‘partners’, such as paying to promote financial products to members of their customer loyalty programs. Retail distribution conduct of this kind

for financial products with a niche target market may be incompatible with an issuer’s compliance with its ‘reasonable steps’ obligation.

- › **Comparison websites and social media**—Several CFD issuers market their products through comparison websites and social media. These platforms are open to any consumer and are not restricted to clients likely to be in the target market. Marketing derivatives online to a wide audience increases the likelihood of distribution that is inconsistent with the target market and is a relevant consideration for determining the reasonable steps issuers must take. In particular, issuers (and potentially the comparison site) need to consider the nature of the consumer referral and whether their controls are effective in limiting product distribution under this method to the target market: see [RG 274](#) at RG 274.207. In addition to their design and distribution obligations, issuers and distributors should consider whether comparison websites or social media ‘finfluencers’ they engage are providing financial services (e.g. financial product advice or arranging to deal in financial products) and, if so, whether they are required to hold an Australian financial services (AFS) licence or be an authorised representative of an AFS licensee. Issuers should also take care that comparison websites or social media ‘finfluencers’ they engage do not make any misleading or deceptive statements about the financial product: see [Information Sheet 269](#) *Discussing financial products and services online* (INFO 269).



Inappropriate incentives

Offering incentives or inducements to encourage prospective consumers to trade in complex and high-risk products runs the risk of attracting consumers that are not in the target market. It may also increase the likelihood of poor consumer outcomes, particularly if there are weaknesses in distribution and monitoring controls.

Poorly designed incentives for staff could also encourage behaviour that may result in consumer harm or distribution being inconsistent with the TMD, misleading and deceptive conduct or unconscionable conduct where the behaviour is more egregious: see Table 4 and Table 6 in [RG 274](#).

Since March 2021, the CFD Order has prohibited CFD issuers from offering or giving benefits—such as gifts, discounts, rebates, trading credits or rewards—as an inducement to a retail client in connection with opening a CFD trading account, funding an account or acquiring a CFD.

Issuers of other high-risk financial products (not subject to the CFD Order) should consider whether offering or giving inducements to retail clients in the course of its retail product distribution conduct may contravene the design and distribution obligations.

We took strong enforcement action where we identified breaches of financial services laws involving misuse of incentives and high-pressure sales tactics: see [Media Release \(20-246MR\)](#) *Federal Court imposes \$75 million penalty on OTC derivative issuer AGM Markets and former authorised representatives OT Markets and Ozifin* (19 October 2020).

The better practices that we observed included retail OTC derivative issuers who implemented a 'no inducement' policy for both retail and wholesale clients in relation to OTC derivatives due to the complex nature of the products.

Areas for improvement

- › **Promotion of 'zero' brokerage offers**—We have warned brokers to be careful about offers of 'zero' or 'low-cost' brokerage where the true cost of trading is masked: see [Media Release \(22-239MR\)](#) *ASIC warns brokers considering high-risk offers to retail investors* (31 August 2022). The law prohibits conduct that is misleading or deceptive, or likely to mislead or deceive, in relation to financial products or services. Issuers that claim to offer zero or low-cost trading should carefully consider whether they may be in breach of the law.
- › **Staff incentives to promote increased trading**—Retail OTC derivative issuers who offer incentives to staff to encourage retail clients to trade more frequently or with larger amounts need effective controls for distributing derivatives consistent with the TMD and to comply with general licensee obligations and other financial services laws, such as prohibitions against unconscionable conduct.

Key observations: Monitoring and review arrangements

To ensure that the TMD remains appropriate for the financial product over time, issuers must review the TMD:

- › periodically
- › in response to review triggers, or
- › when other events or circumstances reasonably suggest that the TMD is no longer appropriate: s994C.

(See [RG 274](#) at RG 274.148.)

Issuers also have discretion to review a TMD for a product at any time or to make a new TMD: s994C(1).

The issuer must remove the product from the market and direct distributors to stop distributing the product as soon as practicable, but in any event within 10 business days of a review trigger or when another event or circumstance occurs which reasonably suggests that the TMD is no longer appropriate—unless the TMD has been reviewed and, if necessary, a new TMD made: s994C(3)–(6).

These are important measures for issuers of high-risk financial products (such as derivatives) where there is significant risk of harm to a retail client who obtains an inappropriate product. If a review finds that the product is not operating as intended or presents significant consumer harms, the issuer must take action. An issuer may need to change a product's design, target market or distribution arrangements, or cease offering the product altogether.

Issuers must have in place arrangements to identify areas of likely consumer harm and other factors that may indicate a TMD review is required: see [RG 274](#) at RG 274.152.



Product and target market review

Retail OTC derivative issuers must allow for regular monitoring and review of their product's performance to ensure that the TMD remains appropriate for that product: s994B(8) and 994C.

We found that issuers generally had a framework in place to monitor review triggers or other events or circumstances that would prompt the issuer to conduct a review. However, as reported in [REP 762](#) for issuers of investment products, we found room for improvement in the case of review triggers set by retail OTC derivative issuers to identify whether the TMD is no longer appropriate.

Some examples of good practices that we observed concerning review triggers include:

- › **Client outcome reviews**—We observed one issuer who conducted regular reviews to monitor the frequency, value and time period of losses when reviewing client outcomes to determine if the data indicated that the target market might not be appropriate and should be adjusted appropriately.
- › **Realistic complaint triggers**—Rather than define their review triggers with reference to a number of complaints, one issuer noted that the nature of each complaint was reviewed to determine if the TMD required a review. Another issuer based their review trigger on a percentage increase of complaints compared to the average percentage of complaints rather than their total client base. For example, if on average an issuer received 0.5% of their customers lodging a complaint each month, a review was triggered if there was an increase of 15% above this level (i.e. 0.6%).

Areas for improvement

We found issuers still need to improve how they monitor the appropriateness of their TMD:

- › **Unrealistic review triggers**—We found that the majority of retail OTC derivative issuers had set their review triggers based on a percentage of complaints received within a given period of time. While consumer complaints are a useful source of information, we observed that the threshold set by many issuers to trigger a review of the product and the TMD was too high and was unrealistic when taking into account the average number of complaints received on a monthly basis. This meant there was a low probability of a review trigger being instigated. In some cases, review triggers required the complaints received by an issuer to be up to 15 times higher than the level of complaints received historically. This fails to achieve the purpose of identifying circumstances where the TMD may no longer be appropriate.
- › **Not using all available information**—Some issuers limited their monitoring to certain points of information (such as information gathered during client onboarding) and did not consider other crucial information throughout the lifecycle of the product, such as consumer transactions, behaviour, questions, complaints and outcomes. To meet their review obligations, issuers need to have adequate data capabilities to ensure their data is timely, accurate, adequate and complete so that they are able to monitor whether their products remain appropriate for the target market. Issuers must take into account all available information about events and circumstances that could reasonably suggest the TMD is no longer appropriate: see [RG 274](#) at RG 274.152–RG 274.154.

- › **Responding to review triggers**—Some issuers appeared more reactive than others in responding to triggers—for example, discovering concerns with individual consumers, rather than proactively monitoring and analysing their available data to ensure the product remains appropriate for consumers in the target market. Issuers need to ensure they know what information is likely to be required to promptly identify if a review trigger has occurred: see [RG 274](#) at RG 274.106. They should also have clear governance and monitoring arrangements and processes in place to ensure their staff know how to appropriately respond to their review triggers.



Supervisory arrangements and monitoring

Retail OTC derivative issuers and distributors must implement and maintain robust and effective product governance arrangements across the product design, distribution, monitoring and review stages to ensure they comply with the design and distribution obligations: see [RG 274](#) at RG 274.32 and RG 274.35.

For product governance arrangements to be effective, issuers and distributors must:

- › document their product governance arrangements in some form: see [RG 274](#) at RG 274.53
- › fully implement these arrangements, and monitor and report on their use: see [RG 274](#) at RG 274.54–RG 274.56, and
- › regularly review the effectiveness of these arrangements and ensure they are up to date: see [RG 274](#) at RG 274.57–RG 274.58.

The boards of retail OTC derivative issuers and distributors should remain engaged with their firm's product governance arrangements in ensuring their firm's ongoing compliance with the design and distribution obligations.

We observed that most issuers we reviewed had compliance policies and procedures in relation to their design and distribution obligations. Issuers tended to delegate the responsibility of implementing and reviewing these policies to their marketing and compliance departments. A smaller sample of retail OTC derivative issuers extended the function to their sales and dealing teams with the rationale that this would ensure all client data points were reviewed.

Some examples of better practices that we observed include:

- › **Board oversight**—We observed that some issuers' boards take a close interest, actively monitoring product management and client outcomes.
- › **Monitoring of clients' profit and losses**—In one case, the issuer monitored clients' profit and losses, in combination with other factors such as employment status, age, prior trading, annual income and liquid assets. The issuer generated quantitative data reports based on various factors, including volatility measurements and trading patterns that were discussed with senior management and their board to determine whether clients were still in the target market and any significant deviations that may warrant changes to the TMD.
- › **A regular formal review**—One issuer conducted a regular formal review of their TMD every three months. This involved different departments analysing various different client data points received, before cross-checking their results with each other and presenting their findings and recommendations to the board for review.

- › **External review**—One issuer conducted a formal review of their TMD and compliance with their design and distribution obligations, and engaged an external law firm to also review the controls and processes they had in place.
- › **Maintaining distribution in-house**—Many retail OTC derivative issuers exerted control over the distribution of their products by retaining all marketing, sales and advertising in-house. By not permitting third-party distribution, the issuers had greater visibility and control of distribution conduct.
- › **Formal policy framework**—We observed some issuers who embedded formal, documented policies covering distribution, marketing, advertising, product development and governance that were regularly reviewed. Staff received regular, comprehensive training to maintain compliance and familiarity.

Areas for improvement

We found issuers still need to improve how they monitor compliance with their design and distribution obligations:

- › **No formal role for board review in the design and distribution obligations compliance framework**—We observed that few issuers had documented procedures providing for an ongoing role for the board in the framework they had in place to monitor compliance with their design and distribution obligations. A number of issuers delegated this responsibility to their compliance manager and sales and marketing staff, with no involvement from the board. For product governance arrangements to work effectively, issuers and distributors need staff at all levels to understand those arrangements and be committed to their success: see [RG 274](#) at RG 274.55.

- › **Over-reliance on review triggers**—We found some issuers appeared to rely on their review triggers as the basis for reviewing their compliance with design and distribution obligations. The design and distribution obligations require the review process to be established as part of issuer's ongoing product governance arrangements throughout the lifecycle of the product. Issuers must ensure that their arrangements are able to identify areas of likely consumer harm and other factors that may indicate that a review of the TMD is required: see [RG 274](#) at RG 274.152. It is not enough for issuers to rely only on review triggers.
- › **Not taking a proactive role**—Some boards limit their monitoring to receiving compliance updates, but do not actively consider whether the compliance framework that has been established is adequate or can be improved or updated. One issuer confirmed

that the board was not involved in the sign-off of the TMD or the review process relating to the TMD. To meet their monitoring obligations, boards should question management and actively consider what events or circumstances would prompt the board to review their design and distribution obligation processes: see [RG 274](#) at RG 274.35 and RG 274.50.

- › **Not considering appropriateness of new issuance to existing clients**—The design and distribution obligations require issuers to critically assess if a product meets the likely needs, objectives and financial situation of consumers in the target market, including for new issuance of derivatives to existing retail clients. We observed several issuers who continued to issue CFDs to existing clients without considering whether those existing clients were likely to be in the target market for the product. See [RG 274](#) at RG 274.44.

ASIC's ongoing supervisory activities



Areas of future focus

Promoting good financial product design that meets consumer needs and product distribution targeted to the right consumers remain key priorities for ASIC. In the year ahead, we will continue to conduct targeted, risk-based surveillance and take enforcement action where appropriate (including issuing stop orders) to address poor design and distribution of products by issuers and distributors of high-risk products (including retail OTC derivatives).

Our supervisory activities will have a keen focus on what reasonable steps product issuers and distributors are taking to distribute products consistent with the TMD and their monitoring and review arrangements, including review of client outcomes observed across distribution channels. Themes we will continue to monitor closely include:

- › **Retail and wholesale client classification**—We observed that most retail OTC derivative issuers reported that less than 10% of their client base were classified as wholesale clients, whereas some issuers reported significantly higher proportions of wholesale clients. Misclassification of a retail client as a wholesale client would risk denying the client important rights and protections, including those under the design and distribution obligations, the CFD Order and access to external dispute resolution with the Australian Financial Complaints Authority.

Distribution via alternative trading models—Several retail OTC derivative issuers have started offering alternatives to client-initiated trading, through distribution methods such as managed accounts, trading under Power of Attorney, copy trading, model portfolios and

algorithmic trading. We are closely monitoring these developments and plan to conduct targeted review of these emerging distribution practices.

- › **Digital engagement practices and 'gamification'**—We have observed that several CFD trading apps use 'gamification' or other digital engagement practices in their distribution of CFDs to retail clients. We plan to conduct further targeted reviews of complex product issuers' use of practices, such as 'leaderboards' (ranking consumers on the number of trades made, profits, etc.), 'likes' and frequent prompts or notifications from apps. Issuers should consider their governance arrangements for use of digital engagement practices, any association of the practices with adverse consumer outcomes and whether their use complies with the design and distribution obligations, general licensee obligations and other financial services laws, such as prohibitions against misleading or deceptive conduct or unconscionable conduct.
- › **Cross-selling OTC derivatives to share traders**—We have warned brokers to be careful about offering high-risk products and services to retail investors: see [22-239MR](#). We observed some retail OTC derivative issuers using search engine optimisation and website design to direct consumers searching for share trading to account opening pages for retail OTC derivatives. We plan to conduct further surveillance of cross-selling and use of digital engagement practices to assess whether some issuers' distribution conduct contravenes the design and distribution obligations or prohibitions against misleading or deceptive conduct.

- › **Funding of CFD accounts using credit cards**—We have observed a common practice among CFD issuers of allowing clients to fund their trading accounts using credit cards. We also observed most TMDs for CFDs exclude consumers from the target market who cannot afford to lose their money deposited for trading. We plan to conduct a review of CFD issuers' consideration of whether clients who fund their accounts with credit cards are likely to be in the target market for the product.
 - › In [RG 227](#), published in 2011 before the commencement of the design and distribution obligations, we asked CFD issuers to disclose in their PDS whether they meet an ASIC benchmark on opening collateral for a CFD trade, and if not, why not. The benchmark provides that an issuer should generally only accept cash or cash equivalents from consumers as opening collateral when establishing an account to trade CFDs, and if credit cards are used to open accounts, then a limit of \$1,000 only should be applied. We are concerned that if CFD investors experience trading losses they may be exposed to a greater risk of entering into financial difficulty than if they simply provided cash. It is also more likely that investors who are unable to provide cash when opening CFD trading accounts will not hold sufficient funds to maintain margins on an ongoing basis: see [RG 227](#) at RG 227.46–RG 227.47.
 - › **Low number of reportable situation reports**—We have observed a low volume of breach reporting from retail OTC derivative issuers and distributors in comparison to other sectors. In April 2023, we updated guidance to licensees on their obligations regarding breach reporting in [Regulatory Guide 78 Breach reporting by AFS licensees and credit licensees \(RG 78\)](#). We encourage retail OTC derivative issuers to review their compliance with the design and distribution obligations, taking into account the better practices and areas for improvement in this report. If an AFS licensee identifies a 'reportable situation', as defined under s912DAA of the Corporations Act, and including a breach by an authorised representative, the licensee must report the matter to ASIC.
- Crypto-asset trading**—We have seen issuers offering, or planning to offer, crypto-asset trading alongside other regulated products. We are concerned that offering largely unregulated crypto-assets alongside regulated financial products may confuse retail investors who might think that the consumer protections that apply to regulated financial products and services also apply to the unregulated crypto products, where they do not. Retail investors may also underestimate the risks. We are closely monitoring offers to retail investors of high-risk crypto-linked products that constitute financial products or the provision of financial services, including crypto derivatives.

Appendix 1: The design and distribution obligations

Purpose of the design and distribution obligations

The design and distribution obligations help consumers to obtain appropriate products and require issuers to distribute those products in a targeted manner.

The obligations address the shortcomings of disclosure and are ultimately intended to reduce the risk of harm caused by poor product design and distribution.

What issuers must do to comply

Issuers of financial products must comply with the design and distribution obligations if they are required to prepare a PDS or a prospectus.

To comply with the obligations, issuers must:

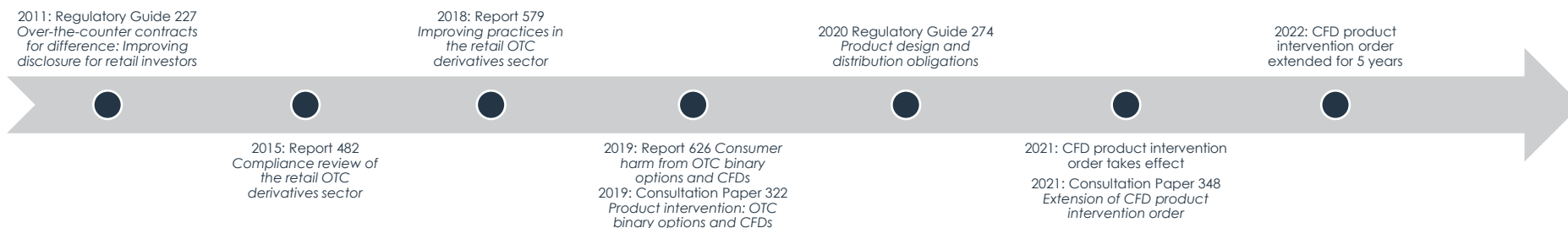
- › prepare a TMD which must describe an appropriate target market, specify appropriate distribution conditions and meet a number of content requirements, including information relating to the review and monitoring of the financial product, and
- › take reasonable steps to make it likely for the financial product to reach consumers in the target market.

Issuers must also:

- › monitor and review outcomes for consumers who have obtained the financial product, and
- › consider whether changes to the financial product, the way it is distributed or to whom it is being provided (based on how the financial product performed for specific consumers and whether it resulted in poor outcomes for those consumers) are required.

We may take action where there are breaches of the design and distribution obligations by using our stop order powers and/or pursuing civil or criminal penalties (up to 2.5 million [penalty units](#)).

Appendix 2: Timeline of ASIC publications on retail OTC derivatives



- › [Regulatory Guide 227 Over-the-counter contracts for difference: Improving disclosure for retail investors \(2011\)](#): Introduced seven disclosure benchmarks to help retail clients understand the risks and benefits associated with CFDs, and decide whether CFDs are suitable for them. This included a client qualification test (questionnaire) that issuers were recommended to maintain, setting out minimum qualification criteria.
- › [Report 482 Compliance review of the retail OTC derivatives sector \(2015\)](#): Review of ASIC's findings on seven key compliance risks relating to CFD issuers.
- › [Report 579 Improving practices in the retail OTC derivatives sector \(2018\)](#): Revealed practices which fell short of ASIC's expectations.
- › [Report 626 Consumer harm from OTC binary options and CFDs \(2019\)](#): Gave a snapshot of the level of harm experienced by retail clients, with 80% and 72% having lost money trading binary options and CFDs, respectively.
- › [Consultation Paper 322 Product intervention: OTC binary options and CFDs \(2019\)](#): Highlighted 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.
- › [Regulatory Guide 274 Product design and distribution obligations \(2020\)](#): Explains our interpretation of the design and distribution obligations, our expectations for compliance, and our general approach to administering the obligations.
- › [ASIC Corporations \(Product Intervention Order—Contracts for Difference\) Instrument 2020/986](#): Effective from 29 March 2021, it imposes conditions on the issue and distribution of CFDs to retail clients by reducing CFD leverage available to retail clients and by targeting CFD product features and sales practices that amplify retail clients' CFD losses. It also brings Australian practice into line with protections in force in comparable markets elsewhere.

› [Consultation Paper 348 Extension of the CFD product intervention order \(2021\)](#): Our analysis highlighted a substantial reduction in retail clients' aggregate net losses—from a quarterly average of \$372 million in the year prior to the CFD Order to \$22 million for the relevant period reviewed. It also noted that the proportion of profit-making and loss-making retail client accounts was still found to be evenly split at 50% (compared with a quarterly

average of 36% profit-making accounts verses 64% loss-making accounts during that period).

› [ASIC Corporations \(Product Intervention Order Extension—Contracts for Difference\) Instrument 2022/259](#): Extended the CFD Order for a further five years to 23 May 2027.

Key terms and related information

Key terms

CFDs	Leveraged OTC derivatives that allow clients to speculate on the change in value of an underlying asset
CFD Order	<i>ASIC Corporations (Product Intervention Order—Contracts for Difference) Instrument 2020/986</i> . A product intervention order imposing conditions on the issue and distribution of CFDs to retail clients
Corporations Act	<i>Corporations Act 2001</i> , including regulations made for the purposes of that Act
design and distribution obligations	The obligations contained in Pt 7.8A of the Corporations Act
distributor	Means a regulated person as defined in s994A(1) of the Corporations Act
issuer	A person who is subject to the TMD requirements in s994B (including sellers in a regulated sale situation), unless indicated otherwise
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

PDS	A Product Disclosure Statement—a document that must be given to a retail client for the offer or issue of a financial product in accordance with Div 2 of Pt 7.9 of the Corporations Act Note: See s761A for the exact definition.
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 CFDs
RG 274 (for example)	An ASIC regulatory guide (in this example, numbered 274)
s994E (for example)	A section of the Corporations Act (in this example numbered 994E), unless otherwise specified
target market	The class of consumers described in the TMD for the product under s994B(5)(b) of the Corporations Act
target market determination	Has the meaning given in s994B of the Corporations Act
TMD	Target market determination document
wholesale client	Has the same meaning as defined in s761A of the Corporations Act

Related information

Headnotes

CFDs, design and distribution obligations, issuers, product design, reasonable steps obligation, retail OTC derivative issuers, target market determination, TMD

Legislation

Corporations Act 2001, Pt 7.8A including s994A(1), 994B, 994C and 994E

ASIC documents

[RG 227](#) *Over-the-counter contracts for difference: Improving disclosure for retail investors*

[RG 234](#) *Advertising financial products and services (including credit): Good practice guidance*

[RG 274](#) *Product design and distribution obligations*

[REP 482](#) *Compliance review of the retail OTC derivatives sector*

[REP 579](#) *Improving practices in the retail OTC derivatives sector*

[REP 626](#) *Consumer harm from OTC binary options and CFDs*

[REP 754](#) *Target market determinations for small amount credit contracts*

[REP 762](#) *Design and distribution obligations: Investment products*

[CP 322](#) *Product Intervention: OTC binary options and CFDs*

[CP 348](#) *Extension of CFD product intervention order*

[22-194MR](#) *ASIC's first DDO stop orders to prevent offer of financial products to consumers*

[23-056MR](#) *ASIC places interim stop orders on TMD and PDS for securities lending product*

[23-127MR](#) *Saxo Capital Markets amends TMDs following ASIC stop orders*

[23-141MR](#) *ASIC issues first DDO stop order for failure to take reasonable steps in CFD distribution*

[23-204MR](#) *ASIC sues eToro in its first design and distribution action to protect consumers from high-risk CFD products*