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Submissions regarding the Design and Distribution Obligations and Product Intervention Power – draft legislation

1. Preamble

The CFD & FX Forum is pleased to provide submissions regarding the exposure draft of the Treasury Laws Amendment (Design and Distribution Obligations and Product Intervention Powers) Bill 2017.

The CFD & FX Forum and each of its members ("Members") are committed to enhancing the efficient operation, transparency and overall investor understanding and confidence in CFDs and FX within Australia, and in the Australian CFD and FX industry as a whole.

Representing 64%¹ of Australian CFD & FX providers by market share, the CFD & FX Forum has established Best Practice Standards ("Standards") for the purpose of continuously improving existing CFD and FX industry standards and addressing specific CFD and FX industry issues and investor concerns, building upon existing legislation to deliver additional benefits to investors and elevating investor perception and understanding in dealing in CFD and FX products.

The CFD & FX Forum considers its submissions regarding the draft legislation as an opportunity to work with ASIC in implementing best practice across the wider industry.

2. Introduction

The CFD & FX Forum has the following general comments to make regarding the draft legislation. Specific submissions are considered further below with reference to the relevant sections of the draft legislation:

- we agree that target market determinations should only apply to retail clients and support the requirement for such determinations to be made before a firm deals in or provides financial advice in relation to a product;
- provided that a firm makes a new target market determination within a reasonable timeframe, the firm should not be required to stop dealing in or providing financial product advice until a new target market determination is made;
- we consider it more reasonable and practical for a product to meet *one or more* of the 'objectives, financial situations or needs' of all persons in a target market, rather requiring a product to meet all the 'objectives, financial situations or needs' of all persons as the draft legislation currently implies;
- The draft legislation does not take into account the use of websites as a communication channel, and whether a firm needs to ensure that web page content is suitable for all consumers who visit

¹ June 2016 Investment Trends Report

a website and whether those consumers must be within the firm's target market. In our view, a firm should be able to publish general advice on websites without being required to tailor the information to take into account the fact that people outside the target market may access the information;

- further clarification is needed in respect of the record keeping and notification obligations to take into account offerors of leveraged products. In particular, it is unclear whether persons providing general advice are required to record each and every instance that general advice is provided. If that is the case, we consider such a requirement to be overly burdensome and problematic for general advice issuers; we consider the ASIC notification requirements to be a re-statement of the existing breach reporting obligations for Australian financial services ("AFS") licensees and that the requirements should fall under the existing regime;
- the proposed additional requirements in relation to advertising and promotions do not provide any additional protection to retail clients over and above the existing obligations imposed on AFS licensees and are impractical for firms that rely heavily on online advertising;
- we agree that ASIC's product intervention powers should be limited to making orders in respect of financial products that are available to retail clients only;
- further clarification is needed regarding both the meaning of 'significant detriment' and the factors that ASIC must take into account in making such a determination;
- use of the product intervention powers must be appropriate, proportionate, and (where relevant) applied to the individuals rather than the product itself. To ensure that any action taken under the product intervention powers is proportionate, and to provide the industry with certainty, ASIC should be required to satisfy further detailed, objective criteria (including exhaustion of all supervisory and/or enforcement actions) before making a product intervention order; and
- we are concerned that ASIC's failure to comply with the 'mandatory' consultation provisions set out in the draft legislation has no bearing on the validity of a product. On the face of it this particular provision appears to be contradictory and we would appreciate clarification as to its intended operation.

3. Submissions

A. Amendments relating to the Design and Distribution of Financial Products

Section 993DB Target market determinations for financial products

We agree that a target market determination is required only in relation to financial products issued to retail clients, owing to the fact that existing disclosure requirements for AFS licensees, (including the preparation and issuing of product disclosure statements) generally only apply to retail clients.

We are supportive of the Government's work in protecting Australian retail consumers from poor practices of financial product issuers and distributors, by way of introducing an obligation on responsible persons to make a target market determination for a financial product before a person deals in the product, or provides financial product advice in relation to the product.

Section 993DC Target market determinations to be reviewed

We consider that more flexibility is required in terms of the timeframe between when a firm identifies an event or a review trigger, and when a firm is required to make a new target market determination.

In our view, provided that a firm makes a new target market determination within a reasonable timeframe (for example, 'as soon as reasonably practicable'), the firm should not be required to refrain from dealing in or providing financial advice in relation to a product until the new target market

determination is made. This is particularly important in respect of products that are not issued on a 'one-off' basis.

Section 993DE Reasonable steps to ensure target market determinations given effect to

The wording of this section, when read in conjunction provision regarding the appropriateness of target market determinations in section 993DB(10), implies that a product issued in a particular target market should meet *all* of the objectives, financial situations or needs for all persons in the target market. We consider this to be unreasonable. In line with the views of the Australian Financial Markets Association ("AFMA"), we suggest that the draft legislation be amended so that a product is only required to meet 'one or more objectives, financial situations or needs' of the persons in a target market.

In addition, given the breadth of access to websites that a firm will commonly use to provide information, and in many cases general advice, about its financial products and services to consumers, it is unclear whether a firm needs to ensure that such content is suitable for all consumers who visit the website, (regardless of the fact that these consumers may not become clients of the firm) and additionally, whether the firm must ensure that all those people must fall within the firm's target market. Such an approach is problematic and unnecessary because information on a firm's website is generally targeted at consumers who will become clients of the firm, and those consumers will naturally fall within the target market. However, a firm should be able to publish general advice on websites without being required to tailor the information to take into account the fact that people outside the target market may access the information.

We also suggest that further clarification as to the form that a target market determination should take should be provided in ASIC guidance.

Section 993DF Record keeping and notification obligations

This section as drafted is very prescriptive and we believe that it does not appropriately consider the nuances of leveraged products. For example, the following matters are unclear when applied to CFD and FX industry participants:

- whether the 'number of issues and sales' relates to the number of transactions or, in the context of a leveraged product, the number of contracts that comprise the transaction (s993DF(2)(c); and
- what the term 'dollar value' means in relation to a leveraged trade (s993DF(2)(d)).

It is also unclear whether persons providing general advice are required to record each and every instance that general advice is provided. If this is the intent of the draft legislation, it would prove both overly burdensome and problematic for issuers of general advice. Whilst general advice may be provided directly to a client over the phone, face-to-face, via emails, via 'live' chat, via social media interactions, and other online methods of corresponding, general advice can also be issued to a broad audience via a firm's website, in bulk emails, newsletters, and in financial product promotions. It is our view that having to record each and every instance of general advice issued is unnecessary given the nature of general advice (i.e. general product information only which does not take into account a client's objectives, financial situation and needs), and would result in an increased compliance cost and regulatory burden.

Section 993DG Notifications to ASIC

This section is essentially a repetition of the existing breach reporting obligations already imposed on AFS licensees under s912D of the *Corporations Act 2001* ("Corporations Act"). Accordingly, we suggest that the obligations on firms to notify ASIC of a breach of the legislation should simply fall under the existing breach reporting regime, rather than being re-stated in this section.

In addition 'significant dealing' is not defined and therefore the type of activity that would constitute such a dealing is unclear.

Subparagraphs 1018A(1)(c)(ii)(ca) and 1018A(2)(c)(ca)

Under the draft legislation, a firm is only permitted to promote products in accordance with the relevant target market determination. In addition, firms are already required to include risk warnings, product disclosure statement references and comply with Regulatory Guide 234 disclosure requirements in respect of their advertising and promotions.

CFD and FX firms occupy a particularly niche sector of the financial services industry and operate predominantly under centralised business models, without branches to support the distribution of advertising and promotional materials. For this reason, firms in our sector are much more reliant on online advertising than other industry participants.

Copied below are two examples of common forms of online advertising utilised by participants in the CFD and FX industry sector. These images illustrate the level of disclosure content that firms must already incorporate into their material in order to comply with the existing regime:

Banner advertisement:



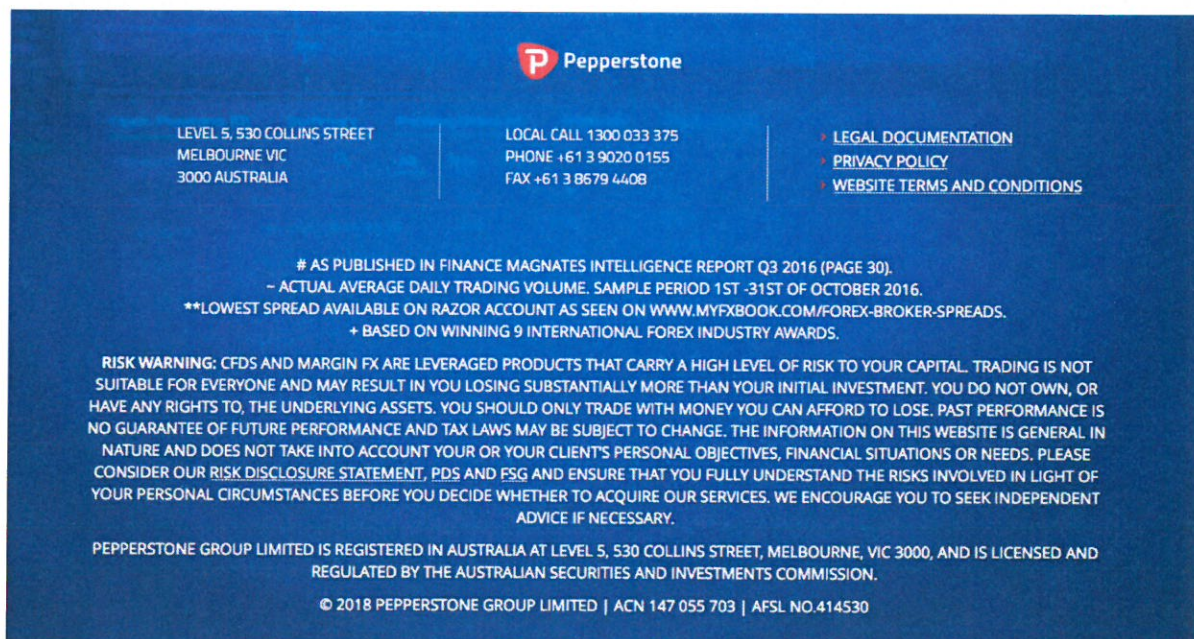
#1 TRADE WITH AUSTRALIA'S
No.1 CFD PROVIDER*

Get started

IG

*See IG.com.au for details. Losses can exceed deposits. Refer to our PDS. IG Markets Limited AFSL 2204

Website (footer):



Pepperstone

LEVEL 5, 530 COLLINS STREET
MELBOURNE VIC
3000 AUSTRALIA

LOCAL CALL 1300 033 375
PHONE +61 3 9020 0155
FAX +61 3 8679 4408

- LEGAL DOCUMENTATION
- PRIVACY POLICY
- WEBSITE TERMS AND CONDITIONS

AS PUBLISHED IN FINANCE MAGNATES INTELLIGENCE REPORT Q3 2016 (PAGE 30).
- ACTUAL AVERAGE DAILY TRADING VOLUME. SAMPLE PERIOD 1ST -31ST OF OCTOBER 2016.
**LOWEST SPREAD AVAILABLE ON RAZOR ACCOUNT AS SEEN ON WWW.MYFXBOOK.COM/FOREX-BROKER-SPREADS.
+ BASED ON WINNING 9 INTERNATIONAL FOREX INDUSTRY AWARDS.

RISK WARNING: CFDs AND MARGIN FX ARE LEVERAGED PRODUCTS THAT CARRY A HIGH LEVEL OF RISK TO YOUR CAPITAL. TRADING IS NOT SUITABLE FOR EVERYONE AND MAY RESULT IN YOU LOSING SUBSTANTIALLY MORE THAN YOUR INITIAL INVESTMENT. YOU DO NOT OWN, OR HAVE ANY RIGHTS TO, THE UNDERLYING ASSETS. YOU SHOULD ONLY TRADE WITH MONEY YOU CAN AFFORD TO LOSE. PAST PERFORMANCE IS NO GUARANTEE OF FUTURE PERFORMANCE AND TAX LAWS MAY BE SUBJECT TO CHANGE. THE INFORMATION ON THIS WEBSITE IS GENERAL IN NATURE AND DOES NOT TAKE INTO ACCOUNT YOUR OR YOUR CLIENT'S PERSONAL OBJECTIVES, FINANCIAL SITUATIONS OR NEEDS. PLEASE CONSIDER OUR RISK DISCLOSURE STATEMENT, PDS AND ESG AND ENSURE THAT YOU FULLY UNDERSTAND THE RISKS INVOLVED IN LIGHT OF YOUR PERSONAL CIRCUMSTANCES BEFORE YOU DECIDE WHETHER TO ACQUIRE OUR SERVICES. WE ENCOURAGE YOU TO SEEK INDEPENDENT ADVICE IF NECESSARY.

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We do not consider that the further requirements imposed by the draft legislation provide any additional benefit or protection to the consumer over and above the existing regime.

In addition, we consider that the requirement to include further disclosure content into promotional material is impractical when applied to online advertising, as illustrated by the above examples. Whilst we agree that a firm's target market determination should be readily available to consumers, we believe that linking each online advertisement to a web page containing the determination is sufficient to satisfy this requirement.

B. Amendments relating to Product Intervention Orders

Section 1022CC ASIC may make product intervention orders

We agree that ASIC's product intervention powers should be limited to making orders in respect of financial products that are available to retail clients only. In our view, financial products that are available to wholesale clients should certainly fall outside the scope of the product intervention powers.

Section 1022CD Significant detriment to retail clients

We are concerned that the legislation as drafted may lead to Australian consumers moving their business offshore to product distributors and issuers in unregulated jurisdictions. In order to avoid this unintended consequence, we suggest that the legislation should take into account whether the 'detriment' was caused by AFS licensees, or by unlicensed, offshore brokers – the latter of which will continue to inflict detriment on Australian consumers regardless of whether the product intervention powers are in place.

In addition, we agree with the following comments made by AFMA:

"Further clarification of the meaning of the risk of 'significant consumer detriment' is needed. If it is the risk of loss as a result of the product performing as it was designed to perform then this would not be appropriate. An assessment of detriment based on performance of the product could be highly subjective and any action taken by ASIC needs to consider the potential damage to the issuer or distributor of taking action just because a group of people have lost money. It is also important that the definition of 'significant' is consistent within classes of products, classes of investors and over time. Tolerances to risk and losses and potential detriment are different across different classes of products and investors and this needs to be taken into account."

Section 1022CE ASIC to consult before making product intervention orders

As previously stated in our response to the initial Consultation Paper (dated 15 March 2017), whilst we agree that ASIC should be able to make interventions in certain circumstances, there is significant difference between ASIC imposing a minimum risk warning standard on a product and being able to ban an entire class of products. In our view, more is required to ensure that actions taken by ASIC under the powers are proportionate in the circumstances.

For example, due weight should be given to the fact that in some instances in an industry it is fringe or individual players that can be the main culprit in causing client detriment. In such situations, these firms should first be the target of enforcement, not the product itself. We also consider that a ban on products may be more favourable to some investors than others and that careful consideration should be given to the balance of investor interests before a product intervention order is made.

To ensure a proportionate and appropriate use of the powers and to provide certainty to the industry, we consider that:

- ASIC should be required to take the initiative in banning firms and exhaust all supervisory and/or enforcement actions prior to invoking the product intervention powers. In our view, this would likely eliminate the need to invoke the product intervention powers to ban all product issuers; and
- the legislation should include further detailed, objective criteria for ASIC to satisfy before invoking the product intervention powers, specifically:
 - the total number of consumers affected (as a proportion of total consumers);
 - the financial detriment suffered by consumers; and
 - whether there are any other more appropriate enforcement actions available (for example, a written direction, enforceable undertaking or the imposition of AFS licence conditions).

In addition, we are concerned that ASIC's failure to comply with the 'mandatory' consultation requirements does not invalidate a product intervention order. In our view this particular provision contradicts the preceding consultation requirements set out in section 1022CE of the draft legislation. We would appreciate further clarification regarding the intention behind this provision and how it would operate in practice. In the absence of such explanation we consider that the provision has the potential to invalidate the entire ASIC consultation process set out in the draft legislation

Thank you for the opportunity to participate in this consultation process. We are happy to engage in further discussion and please do not hesitate to contact us for any further assistance.

Yours sincerely,



Kevin Algeo
Chair, Australian CFD & FX Forum