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Australian Regulator Pushes For Greater CFD Disclosure

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ASIC released new disclosure benchmarks for contracts for difference (CFDs) that aim to improve disclosure and investor awareness about risks of these products.

The guidance also covers margin foreign exchange contracts.

In Australia, most CFDs are issued as over-the-counter (OTC) products, making them increasingly accessible and popular with retail investors. But CFDs are a high-risk financial product and their complexity means they are unlikely to meet the investment needs of many retail investors.

ASIC Chairman Greg Medcraft said action was needed to ensure people considering CFDs are aware of the downside as well as the upside.

'CFDs are extremely risky financial products. Most investors don't understand that complexity and they don't get independent financial advice. That means we need CFD issuers to do a much better job of spelling out to investors the risks as well as the rewards of these complex products,' Mr Medcraft says.

'ASIC's number one priority is ensuring investors and financial consumers are confident and informed. We want issuers to work harder to ensure people investing in CFDs better understand what they are getting into – before they start trading.'

Regulatory Guide 227 Over-the-counter contracts for difference: Improving disclosure for retail investors (RG 227) outlines seven benchmarks which aim to help investors understand the risks and benefits of OTC CFDs. Issuers must address these benchmarks in product disclosure statements (PDSs) from 31 March 2012.

The seven benchmarks (see 'Background' for further details) mean issuers will need to address each issue in their PDSs on an 'if not, why not' basis. The benchmarks are:

- client qualification
- opening collateral
- counterparty risk - hedging
- counterparty risk - financial resources
- client money
- suspended or halted underlying assets
- margin calls.

RG 227 also outlines the standards ASIC expects issuers to meet when advertising OTC CFDs to retail investors.

ASIC has previously released an investor guide—Thinking of trading contracts for difference (CFDs)? to help investors understand the benchmarking information in disclosure documents. This guide has general information about CFD operation and risks and indicates what investors should look for when reading PDSs. This will be updated to explain the benchmarks when they become effective from 31 March 2012.

Details on ASIC's consultation and industry responses are summarised in Report 246 Response to submissions on CP 146 OTC CFDs: Improving disclosure for retail investors (REP 246).

Background

CFDs are leveraged derivative products that let investors take a position on the change in the market price of an underlying asset, such as a share or commodity, or the value of an index or a currency exchange rate.

There are currently around 39,000 active CFD investors in Australia. (Investment Trends, 2010 Australia CFD Report, May 2010). The CFD market has seen growth of over 300% in the last five years, and it is reasonable to infer that this growth will continue. (By comparison with the figure of 9000 CFD traders in Australia reported in Investment Trends, 2005 Contracts for Difference Report: Understanding current and next wave CFD traders, September 2005.)

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