Article Information

Authors: Steven Pettigrove, Jake Huang, Michael Bacina
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ASIC targets off-target TMDs

ASIC has issued [Report 770 *Design and distribution obligations: Retail OTC derivatives*] on findings from its recent review of compliance with design and distribution obligations (DDO) by issuers of over-the-counter (OTC) derivatives to retail clients. OTC derivatives include contracts for difference (CFDs), crypto derivatives and novel derivative arrangements.

What are DDO?

DDO require businesses offering retail financial products to assess the needs of users, and to distribute those products in a targeted manner. This includes publishing an appropriate Target Market Determination (**TMD**) before any financial product is provided to retail investors.

ASIC's regulatory powers in relation to DDO are relatively new having been introduced under the *Corporations Act 2001* (Cth) in 2019. Issuers and distributors of financial products have been required to comply with these obligations since 5 October 2021.

ASIC has previously issued regulatory guidance and reports in relation to compliance with DDOs for different financial service sectors:

- Regulatory Guide 274 *Product design and distribution obligations,* published in December 2020;
- Report 754 *Target market determinations for small amount credit contracts*, published in December 2022;
- Report 762 *Design and distribution obligations: Investment products,* published in May 2023

What's new in Report 770?

Report 770 specifically targets the retail OTC derivative sector, which ASIC has long considered risky and a focus for enhanced consumer protections. For example, ASIC has implemented a Public Intervention Order on retail CFD products, which among other things, imposed leverage ratios and negative balance protection for these products.

The report summarizes ASIC's findings for issuers and distributors of retail OTC derivatives (and other financial products) to consider when reviewing DDO compliance. Reflecting on ASIC's recent enforcement actions (e.g. issuing interim stop orders), Report 770 outlines three common areas for improvement:

1. Preparing a TMD, including describing a class of retail clients whose likely objectives, financial situation and needs are met by complex, high-risk derivatives – a factor in 9 interim stop orders;
2. Taking 'reasonable steps' that will, or are reasonably likely to, result in the derivatives reaching retail clients in the target market – a factor in 1 interim stop order; and
3. Monitoring client outcomes to ensure that the TMD and product governance arrangements remain appropriate

In the report ASIC also outlines several key findings, some are related to drafting an appropriate TMD, while others focus on taking reasonable steps in distributing OTC derivative products:

- Better use of available client data in defining target market;
- Some TMDs need sufficient granularity;
- Avoid over-reliance on client questionnaires as a primary distribution filter;

- Avoid over-reliance on existing controls developed prior to the commencement of the DDO regime;
- Review mass marketing of OTC derivatives;
- Avoid poorly defined TMD review triggers; and
- More leadership engagement on DDO compliance.

ASIC's enforcement actions

ASIC has made increasing use of its DDO powers in recent enforcement actions. To date, ASIC has issued 82 interim stop orders under DDO, including 10 orders relating to retail OTC derivatives, e.g. one relating to Saxo Capital Markets which prompted Saxo to amend its TMDs, and another against Mitrade for failure to take reasonable steps to restrict CFD distribution to its target market.

Of the 82 interim stop orders issued, 77 have been lifted following actions taken by entities to address ASIC's concerns, or where the products were withdrawn. 5 orders remain in place.

Further, ASIC has commenced civil penalty proceedings for alleged breaches of DDO 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 (in this case, ASIC allege that eToro failed to appropriately define the target market and made its quiz too easy to pass).

Areas of future focus

Report 770 also lists ASIC's areas of future focus, including appropriate retail and wholesale client classification, which was linked to ASIC cancelling Binance's derivatives licence earlier this year.

ASIC will also focus on issuers who offer crypto-asset trading alongside regulated products such as CFDs:

We are closely monitoring offers to retail investors of high-risk cryptolinked products that constitute financial products or the provision of financial services, including crypto derivatives.

Key lessons

Report 770 and recent ASIC enforcement actions demonstrate the breadth of its DDO powers as a tool for restricting the distribution of financial products to retail investors. This was further underlined this week by ASIC's enforcement action against Kraken over allegations that it failed to issue a TMD for a margin trading product, We expect to see a continued focus from ASIC on TMD compliance and implementation and crypto-based offerings as two of its core priorities under its current Corporate Plan.

Those who offer or distribute OTC derivatives to retail users and crypto-asset linked financial products should carefully review their TMD and product governance arrangements taking into account ASIC's findings.