



ASIC

Australian Securities & Investments Commission

REGULATORY GUIDE 219

Non-standard margin lending facilities: Disclosure to investors

November 2010

About this guide

This is a guide for providers, advisers and others involved with the issue of non-standard margin lending facilities.

It sets out ASIC's expectations for improved disclosure to:

- help investors understand and assess these products; and
- ensure investors have all the information they need to make an informed investment decision.

Note: In providing this guidance, ASIC seeks to improve the disclosure given to investors about these products. However, this should not be regarded as an indication that ASIC regards these products as being suitable for all or most investors.

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 guide was issued on 10 November 2010 and is based on legislation and regulations as at 10 November 2010.

Disclaimer

This guide does not constitute legal advice. We encourage you to seek your own professional advice to find out how the Corporations Act and other applicable laws apply to you, as it is your responsibility to determine your obligations.

Examples in this guide are purely for illustration; they are not exhaustive and are not intended to impose or imply particular rules or requirements.

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A Overview

Key points

The *Corporations Act 2001* regulates margin lending facilities as financial products. Standard margin lending facilities are subject to a tailored disclosure regime under the Corporations Regulations 2001.

We expect providers of non-standard margin lending facilities to meet the requirements of the tailored regime for standard margin lending facilities, as well our expectations for disclosure set out in RG 219.20–RG 219.24.

While this guide sets out our expectations for disclosure about non-standard margin lending facilities, it should not be regarded as an indication that we regard these products as being suitable for all or most investors.

Regulatory framework

- RG 219.1 The disclosure framework in the *Corporations Act 2001* (Corporations Act) requires the provider of a non-standard margin lending facility to disclose upfront all the information a retail client reasonably needs to know in order to make a decision whether to acquire the product: s1013D.
- RG 219.2 Disclosure is not designed to stop retail clients from taking investment risks, but to help them understand the risks involved in any particular investment or type of investment. This enables them to make informed decisions about whether the potential rewards (the returns on their investments) match the level of risk involved, and whether they are prepared to take on that risk.
- RG 219.3 The complexity and risk inherent in non-standard margin lending facilities means that these types of products are unlikely to be appropriate for the investment objectives, needs and risk profile of many retail clients.

Note: A provider must not issue, or increase the limit of, a margin lending facility to a retail client if the facility is unsuitable for the retail client: s985K.

What is a non-standard margin lending facility?

- RG 219.4 The Corporations Act defines a ‘non-standard margin lending facility’ as a facility under the terms of which:
- (a) a natural person (the ‘client’) transfers one or more marketable securities, or a beneficial interest in one or more marketable securities (the ‘transferred securities’), to another person (the ‘provider’);

- (b) the provider transfers property to the client (the ‘transferred property’) as consideration or security for the transferred securities;
- (c) the transferred property is, or must be, applied wholly or partly to acquire one or more financial products, or a beneficial interest in one or more financial products;
- (d) the client has a right, in the circumstances determined under the terms of the facility, to be given marketable securities equivalent to the transferred securities; and
- (e) if the current loan-to-value ratio (LVR) of the facility exceeds a ratio, percentage, proportion or level (however described) determined under the terms of the facility, then:
 - (i) the client becomes required to take action;
 - (ii) the provider becomes entitled to take action; or
 - (iii) another person becomes required or entitled to take action,
 in accordance with the terms of the facility to reduce the current LVR of the facility.

Note: See s761EA(5).

- RG 219.5 Typically, a non-standard margin lending facility is not based on a loan agreement, but uses a type of securities lending and/or repurchase agreement (with variations) to achieve a similar financial outcome to a standard margin lending facility.
- RG 219.6 The definition of a non-standard margin lending facility is intended to capture alternative legal structures where the client transfers title or a beneficial interest in marketable securities to the provider and merely has a right to be given equivalent marketable securities in specified circumstances.
- RG 219.7 Standard and non-standard margin lending facilities appear substantially similar from the investor’s perspective (e.g. in terms of the use of gearing to magnify the size of the investment portfolio, the application of an LVR and margin calls, and the impact of market changes on the value of the investment portfolio); however, the two product types pose significantly different risks for investors. Although the legal structure of a non-standard margin lending facility is different from that of a standard margin lending facility, both types have typically been marketed to retail clients as ‘margin loan’ products, thus causing some confusion for investors about the nature of their investment.
- RG 219.8 In addition to regulating standard and non-standard margin lending facilities, the Corporations Act gives ASIC power to declare that a particular kind of facility is a margin lending facility. These powers are necessary to:

- (a) deal with product innovation and the likelihood that, over time, new margin loan structures will evolve that may not be captured by the current definition, and
- (b) ensure that the relevant investor protection provisions continue to apply to these products.

Disclosure requirements for non-standard margin lending facilities

RG 219.9 Providers of non-standard margin lending facilities will need to comply with the general content requirements for Product Disclosure Statements (PDSs) under Pt 7.9 of the Corporations Act. RG 219.20–RG 219.24 represent our expectations about the key content areas that we believe are essential if a PDS is to be fully effective in communicating to retail clients the features and risks of a product. However, providers should be aware that these expectations for disclosure supplement, but do not remove, the requirement to comply with the PDS content requirements under s1013D and Pt 7.9 generally.

RG 219.10 Clear and concise disclosure explaining the structure of the facility and the key risks is also useful for clients in understanding the product they are considering acquiring.

RG 219.11 RG 219.20–RG 219.22 set out our expectations about the key questions that a retail client should ask before purchasing a product. We expect that the issuer will answer those questions in the PDS.

Note: ASIC has produced information for investors about margin loans, non-standard margin lending facilities and stock lending arrangements, which is available from our FIDO website: www.fido.asic.gov.au.

RG 219.12 Our expectations reflect the content requirements identified by the Australian Government in the tailored disclosure regime for standard margin lending facilities; however, we believe additional disclosure is also required to recognise the specific features and risks of non-standard margin lending facilities.

RG 219.13 While the disclosure obligations in Ch 7 of the Corporations Act apply to transactions with retail clients, we encourage providers to adopt similar principles for other clients. For example, they should consider giving a prominent explanation of the distinction between a standard margin loan and a non-standard margin lending facility when dealing with individual investors who are not retail clients.

Underlying principles

RG 219.14 We believe that our approach balances:

- (a) the need to improve disclosure to allow retail clients to make better-informed decisions; and
- (b) the desirability of not interfering unduly with this market.

Note: The need to strike an appropriate balance between protecting retail clients' interests and allowing markets to operate freely is part of ASIC's mandate under the *Australian Securities and Investments Commission Act 2001*.

RG 219.15 Our approach cannot prevent investments failing, nor ensure that they perform to retail clients' expectations. However, better disclosure can help retail clients make better risk–reward decisions.

RG 219.16 Our approach should not result in longer disclosures. Recent experience shows that retail clients need better quality and relevant disclosure, presented in a way best suited to client understanding.

B Our expectations for disclosure

Key points

We expect that, in order to meet their disclosure obligations under Ch 7 of the Corporations Act, a provider of a non-standard margin lending facility will address the following issues in the PDS given to a retail client:

- the key issues applicable to a standard margin lending facility, to the extent that they are relevant to the non-standard facility (see RG 219.17–RG 219.19);
- the additional key features of a non-standard margin lending facility, as outlined at RG 219.20–RG 219.23; and
- any additional key issues that would influence a retail client's decision to purchase the product (see RG 219.24).

We also expect that a provider of a non-standard margin lending facility will state clearly and prominently in the PDS that they are providing a non-standard margin lending facility, and explain how that differs from a standard margin lending facility.

Disclosure regime for standard margin lending facilities

- RG 219.17 The Australian Government has developed a tailored disclosure regime for standard margin lending facilities. This regime is set out in Sch 10C of the Corporations Regulations 2001 (Corporations Regulations).
- RG 219.18 This regime replaces the PDS content obligations in Pt 7.9. It provides for more structured and comparable PDSs. Key principles underlying this work are:
- (a) the new short PDS must contain a summary of the key information a retail client needs to know to make an investment decision; and
 - (b) the short-form document must be in 'stark language', of the kind that can be readily understood by retail clients.
- RG 219.19 In summary, the Corporations Regulations provide that a PDS for a standard margin lending facility must include:
- (a) a short description of the margin loan provider and its business;
 - (b) a short summary of what margin lending is, including:
 - (i) a statement setting out the possible consequences of borrowing to invest, including the effect of magnifying both gains and losses;
 - (ii) a statement that the client should regularly monitor their portfolio so that they can be aware of changes to the terms of the margin

- loan and can take timely action to prevent potential losses in relation to their portfolio;
- (iii) a statement that the client may need at short notice to pay an additional amount into the margin loan or sell some of the investments for which the margin loan is made;
 - (iv) a statement that the margin loan provider has the right in certain circumstances to sell all, or part, of the client's portfolio and may not be required under the terms of the margin loan to provide notice to the client of its intention to sell;
 - (v) a statement that if the value of the portfolio for a margin loan does not cover the cost of repayments for the margin loan, the client may need to access other funds to repay the margin loan or the provider of the margin loan may sell assets provided as security for the margin loan—for example, the client's residential property; and
 - (vi) a statement that the law requires the provider of a margin loan to assess whether the margin loan is unsuitable for the client, and to provide a copy of that assessment if requested;
- (c) a description of the key benefits available to the client of a margin loan;
- (d) an explanation of how margin lending works, including:
- (i) information about the maximum loan amount and the LVRs for the margin loan;
 - (ii) a description of the financial products that the client can purchase with the margin loan;
 - (iii) an explanation of who owns the investments purchased with the margin loan;
 - (iv) a statement informing the client that details of their rights and obligations are set out in the terms of the agreement for the margin loan, recommending that the client read the loan agreement, and explaining how the client can obtain a copy of the loan agreement; and
 - (v) a reference to a calculator, being either a calculator made available by the margin loan provider or a calculator available on ASIC's website;
- (e) an explanation of what a margin call is, including:
- (i) an explanation of when there will be a margin call in response to changes in the market;
 - (ii) an explanation of when there will be a margin call at the discretion of the margin loan provider;
 - (iii) an example of how a margin call works, including the impact of breaching the LVR for the margin loan, how to adjust the LVR

- back to the required level for the margin loan, and how the buffer (if any) for the margin loan operates;
- (iv) a description of how a margin call can be dealt with by the client;
 - (v) a statement that if there is a margin call, the provider of the margin loan will notify the client, or the client's financial advisor, that the margin call has occurred; and
 - (vi) a statement that the client must be contactable at all times in case of a margin call;
- (f) a description of key risks associated with margin lending, including:
- (i) the risk that the value of the client's investments may fall, and the possible consequences for the client if this occurs, in particular the risk of a margin call occurring;
 - (ii) the risk that the lender may change the LVR of an investment and the possible consequences for the client, in particular, the risk of a margin call occurring;
 - (iii) the risk that the margin loan provider may remove any given investment from the Approved Securities List and the possible consequences for the client—in particular, the risk of a margin call occurring;
 - (iv) the risk that the interest rate may rise and the possible consequences for the client—in particular, the possibility that interest payments owed by the client may exceed the returns available from the client's portfolio;
 - (v) the risk of loss of property of the client if the property has been mortgaged as security for, or in connection with, the loan;
 - (vi) the risk of a default event under the loan agreement and the potential consequences for the client if a default event occurs; and
 - (vii) the risk that taxation laws may change and that this may have a negative effect on the tax position for the client;
- (g) a description of the costs of the product, including:
- (i) a description of the interest rate for the loan, including how the interest rate is calculated;
 - (ii) a statement about whether a default interest rate will be charged for the margin loan;
 - (iii) details of any fee or cost charged by the margin loan provider;
 - (iv) a statement about whether a fee or cost charged by the margin loan provider can be unilaterally changed by the provider under the loan agreement; and
 - (v) a statement about whether a commission or fee is payable to a financial advisor or other third party, the circumstances in which a

commission or fee will be payable, and how the client can obtain more detailed information about the commission or fee; and

- (h) a short summary of the dispute resolution system the margin loan provider has for dealing with disputes or complaints about the loan.

Note: See Sch 10C of the Corporations Regulations.

Disclosure regime for non-standard margin lending facilities

RG 219.20 We expect that a provider of a non-standard margin lending facility will state clearly and prominently in the PDS that they are providing a non-standard margin lending facility, and explain how that differs from a standard margin lending facility.

RG 219.21 We expect that, at a minimum, a provider of a non-standard margin lending facility will address the issues covered by the tailored disclosure regime for standard margin lending facilities (see RG 219.19) to the extent relevant to the product to which the PDS relates. We expect that the PDS will address these issues in a clear and concise way.

RG 219.22 In addition to the expectations set out in RG 219.20–RG 219.21, we consider that, in order to meet the general content requirements for a PDS under Pt 7.9, the following key issues that are relevant to non-standard margin lending facilities should also be disclosed:

- (a) an explanation of who owns the investment, covering the transfer of securities from the client to the provider and the client's right to repurchase equivalent marketable securities;
- (b) an explanation of any rights that the client has under the facility—for example, the right to repurchase the transferred securities or the right to terminate the facility;
- (c) an explanation of what the provider will or may do with the transferred securities, including any arrangements that could increase or decrease the risk to the client that the provider will be unable to fulfil a request for repurchase of the transferred securities:
 - (i) for example, we consider that if the provider intends to dispose of the transferred securities in any way (such as on-lending the securities to a third party) or to pool the transferred securities with other clients' securities, this should be explicitly stated in the PDS; and
 - (ii) we consider that the PDS must disclose whether the provider will hold the transferred securities on trust;
- (d) the risks associated with the client transferring title to their marketable securities, including:

- (i) an explanation that in the event that the party with title becomes insolvent, the client will be an unsecured creditor and might not get back all or part of the marketable securities transferred;
 - (ii) the risk that, if the party providing the consideration for title of the securities becomes insolvent, the client may not get full payment for the securities they have already transferred and that existing amounts that have been paid to them might be challenged; and
 - (iii) the risk that despite the transfer of the securities clients may still need to provide extra funds to meet any margin calls relating to any securities that have been transferred under the facility;
- (e) an explicit statement of the possible circumstances in which the provider might not fulfil a request to return equivalent securities, such as:
- (i) the provider on-lending the securities and thus being unable to satisfy a repurchase request;
 - (ii) the provider giving a charge over the securities to a third party;
 - (iii) the provider becoming insolvent;
 - (iv) the provider exercising their discretion under the arrangement to elect not to return the securities or equivalent securities; or
 - (v) if the market for securities is or becomes illiquid and no equivalent securities are available;
- (f) an explanation of the retail client's exposure to counterparty risk (if relevant). The PDS should also provide sufficient explanation to allow the retail client to evaluate the quality of any hedging engaged in by the provider;
- (g) the risk that the client may be exposed to greater than expected loss if, for example, the value of the transferred securities exceeds the value of the transferred property (i.e. the cash advanced). This must include a clear warning to the client of their responsibility to monitor the margin in both a rising and falling market, as well as a clear statement of the client's right to request either return of some or all of the transferred securities or payment of an additional amount of transferred property; and
- (h) an explanation of the tax consequences of the transaction (such as the possibility that the transfer of securities might trigger a capital gains tax event), together with a stark warning that the client should seek tax advice before entering into the transaction.

RG 219.23 Disclosure of these matters must be prominent.

Disclosure of other features

RG 219.24 Where relevant, we expect that the PDS would draw attention to any other key features or risks that would influence the retail client's decision to purchase the product. For example, if the legal structure of the transaction is based on a type of securities lending and/or repurchase agreement, we would expect that the key elements of that agreement would be disclosed in the PDS in a clear, concise and effective manner.

Key terms

Term	Meaning in this document
AFS licence	An Australian financial services licence under s913B of the Corporations Act that authorises a person who carries out a financial services business to provide financial services <p>Note: This is a definition contained in s761A of the Corporations Act.</p>
ASIC	Australian Securities and Investments Commission
Ch 7 (for example)	A chapter of the Corporations Act (in this example numbered 7)
Corporations Act	<i>Corporations Act 2001</i> , including regulations made for the purposes of that Act
Corporations Regulations	Corporations Regulations 2001
financial product	Generally a facility through which, or through the acquisition of which, a person does one or more of the following: <ul style="list-style-type: none"> • makes a financial investment (see s763B); • manages financial risk (see s763C); • makes non-cash payments (see s763D) <p>Note: See Div 3 of Pt 7.1 of the Corporations Act for the exact definition.</p>
LVR	loan-to-value ratio
margin call	Generally, a margin lending facility is in margin call if the current LVR of the facility exceeds a ratio, percentage, proportion or level (however described) determined under the terms of the facility, and: <ul style="list-style-type: none"> • the client becomes required to take action; • the provider becomes entitled to take action; or • another person becomes required or entitled to take action, <p>in accordance with the terms of the facility to reduce the current LVR of the facility</p> <p>Note: See s761EA(2)(e) of the Corporations Act for the exact definition.</p>
margin lending facility	Means 'margin lending facility' as defined in s761EA(1) of the Corporations Act and includes: <ul style="list-style-type: none"> • a standard margin lending facility; • a non-standard margin lending facility; or • a facility declared by ASIC to be a margin lending facility under s761EA(8) of the Corporations Act

Term	Meaning in this document
non-standard margin lending facility	Has the same meaning as in s761EA(5) of the Corporations Act
Product Disclosure Statement (PDS)	A document that must be given to a retail client in relation to 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.
Pt 7.9 (for example)	A part of the Corporations Act (in this example numbered 7.9)
retail client	A client as defined in s761G of the Corporations Act and Ch 7, Pt 7.1, Div 2 of the Corporations Regulations
s761A	A section of the Corporations Act (in this example numbered 761A)
standard margin lending facility	Has the same meaning as in s761EA(2) of the Corporations Act

Related information

Headnotes

disclosure obligations, margin lending, non-standard margin lending facilities, Product Disclosure Statement

Legislation

Corporations Act, Ch 7, Pt 7.9, s761EA(5), 985K, 1013D; Corporations Regulations, Sch 10C

Australian Securities and Investments Commission Act 2001

Consultation papers and reports

CP 129 *Non-standard margin lending facilities: Improving disclosure for retail clients*