



ASIC

Australian Securities & Investments Commission

CONSULTATION PAPER 129

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

December 2009

About this paper

This consultation paper sets out ASIC's proposals on the disclosure requirements we expect a provider of a non-standard margin lending facility to comply with.

The purpose of this paper is to seek the views of providers of margin lending facilities, investors, their legal advisors, and other interested persons, on the proposals we have developed.

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 paper was issued on 21 December 2009 and is based on the Corporations Act as at 21 December 2009.

Disclaimer

The proposals, explanations and examples in this paper do not constitute legal advice. They are also at a preliminary stage only. Our conclusions and views may change as a result of the comments we receive or as other circumstances change.

At the date of issue of this paper:

- the margin lending amendments made by the *Corporations Legislation Amendment (Financial Services Modernisation) Act 2009* had not commenced; and
- the amendments to the Corporations Regulations proposed to be made as a consequence of that Act were in exposure draft form and therefore subject to change before being made final.

Once the regulations are made final, we will update our guidance if necessary.

Contents

The consultation process	4
A Regulation of margin lending	6
Margin lending facilities are ‘financial products’ under Ch 7	6
What is a non-standard margin lending facility.....	6
Regulation of arrangements that are not non-standard margin lending facilities	9
B Our proposal for disclosure for non-standard margin lending facilities	10
Disclosure obligations for margin lending facilities.....	10
Proposal for regulatory guidance for providers of non-standard margin lending facilities	10
Proposal for PDS content requirements for non-standard margin lending facilities	11
C Regulatory and financial impact	13
Attachment: Draft regulatory guide	14
Key terms	25

The consultation process

You are invited to comment on the proposals in this paper, which are only an indication of the approach we may take and are not our final policy.

As well as responding to the specific proposals and questions, we also ask you to describe any alternative approaches you think would achieve our objectives.

We are keen to fully understand and assess the financial and other impacts of our proposals and any alternative approaches. Therefore, we ask you to comment on:

- the likely compliance costs;
- the likely effect on competition; and
- other impacts, costs and benefits.

Where possible, we are seeking both quantitative and qualitative information.

We are also keen to hear from you on any other issues you consider important.

Your comments will help us develop our policy on disclosure to retail clients in relation to margin lending facilities. In particular, any information about compliance costs, impacts on competition and other impacts, costs and benefits will be taken into account if we prepare a Business Cost Calculator report and/or a Regulation Impact Statement: see Section C, 'Regulatory and financial impact'.

Making a submission

We will not treat your submission as confidential unless you specifically request that we treat the whole or part of it (such as any financial information) as confidential.

Comments should be sent by 26 February 2010 to:

Geoffrey Leveritt
Senior Lawyer
Strategic Policy
Australian Securities and Investments Commission
GPO Box 9827
Melbourne VIC 3001
facsimile: (03) 9280 3306
email: policy.submissions@asic.gov.au

What will happen next?

Stage 1	21 December 2009	ASIC consultation paper released
Stage 2	26 February 2010	Comments due on the consultation paper
Stage 3	early 2010	Regulatory guide released

A Regulation of margin lending

Key points

Margin lending facilities are regulated as financial products under the Corporations Act.

Standard margin lending facilities are subject to a tailored disclosure regime under the Corporations Regulations 2001.

This paper sets out proposals about how we expect providers of non-standard margin lending facilities to meet their disclosure obligations under the Corporations Act.

Margin lending facilities are ‘financial products’ under Ch 7

- 1 The Council of Australian Governments agreed on 3 July 2008 that the Australian Government would assume responsibility for regulating consumer credit, including margin lending.
- 2 The *Corporations Legislation Amendment (Financial Services Modernisation) Act 2009* regulates margin lending facilities as financial products under Ch 7 of the *Corporations Act 2001* (Corporations Act).
- 3 Under the Corporations Act, a ‘margin lending facility’ is specifically included as a financial product under s764A. This ensures that a provider of financial services in relation to a margin lending facility is required to obtain an Australian financial services (AFS) licence and is subject to the conduct obligations in Ch 7 of the Corporations Act, including the obligation to give a Product Disclosure Statement (PDS).
- 4 The definition of a ‘margin lending facility’ in s761EA(1) of the Corporations Act includes a standard margin lending facility and a non-standard margin lending facility.

What is a non-standard margin lending facility

- 5 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 (this is usually in the form of cash, and represents the ‘loan’ component of the non-standard margin lending facility);
- (c) the transferred property is, or must be, applied by the client 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 call back marketable securities equivalent to the transferred securities; and
- (e) if the current loan-to-value ratio (LVR) of the facility (based on the amount of transferred property/cash ‘loaned’ by the provider to the client and the value of the securities transferred from the client to the provider) 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: s761EA(5).

6 The definition of a ‘non-standard margin lending facility’ is intended to target those arrangements that are not based on a loan agreement, but instead use a type of securities lending agreement (with variations) to achieve a similar economic outcome as would a standard margin lending facility.

7 This type of structure was used by lenders such as Opes Prime Stockbroking Limited and Tricom Equities Limited up until 2008 and was typically marketed as a ‘margin loan’, ‘equity finance’ or ‘securities finance’. The key difference between a standard margin lending facility and a non-standard margin lending facility, from the client’s point of view, is that in a non-standard margin lending facility, title to the transferred securities passes out of the client’s hands. This key aspect of a non-standard margin lending facility is captured in the definition.

8 The Explanatory Memorandum to the Corporations Legislation Amendment (Financial Services Modernisation) Bill 2009 makes clear that the definition of ‘non-standard margin lending facility’ is not intended to capture general securities lending, particularly in the wholesale market.

Example of a non-standard margin lending facility

9 We have provided the following example to assist in understanding the scope and intent of the definition of ‘non-standard margin lending facility’.

Example of non-standard margin lending facility

- Value of the transferred property given by the provider to the client = \$85,000 (equivalent to the loan amount in a standard loan—this might be provided as cash or as a right to draw down an amount of cash to this value).
- Value of the transferred securities transferred by the client to the provider = \$125,000 (value of the marketable securities transferred by the client to the provider, which may, but need not, include some or all of any marketable securities purchased with the loan).
- Margin call occurs if the current LVR is above 80%.
- Original current LVR = $85,000/125,000 = 68\%$.
- Value of the transferred securities falls to \$100,000.
- Current LVR = $85,000/100,000 = 85\%$.
- Facility is in margin call on the date the current LVR exceeds 80%. The provider may be entitled to call for the return of some or all of the excess cash that it has provided, until the new LVR returns to 80%.
- If the value of the transferred securities rises, the onus is on the client to request either a return of some of the securities or for the provider to transfer additional cash to the client.

Note: The above example is based on paras 1.51–1.57 and Example 1.4 in the Explanatory Memorandum to the Corporations Legislation Amendment (Financial Services Modernisation) Bill 2009.

Example of normal securities lending agreement

- 10 A non-standard margin lending facility can be contrasted with a typical securities lending agreement. The object of a securities lending agreement, unlike a margin lending agreement, is for one party (the ‘borrower’) to temporarily secure the legal and beneficial ownership to a parcel of securities. The ‘loaned’ securities might be needed for a variety of purposes (e.g. to cover a short sale). The lender’s motive is to earn incremental income from its portfolio.
- 11 Under a normal securities loan, the borrower undertakes to redeliver ‘equivalent’ securities. Securities are typically only borrowed for short periods and the lender may recall the lent securities at any time. The borrower is required to transfer legal and beneficial ownership in cash, bonds or some other liquid security as collateral for the term of the loan. There are generally no restrictions placed on the uses to which the securities passing between the parties may be put, though sometimes restrictions are placed on the voting of the securities. A fee is paid by the borrower based on the value of the securities borrowed. Borrowers must also make good any benefits lenders would have been entitled to had they retained ownership of the securities (e.g. dividends).

Example of normal securities lending agreement

Under a traditional stock lending arrangement:

- Value of transferred securities from the client to the securities borrower = \$100,000 (the client has a right to demand return of the securities, and the client also retains an economic interest in the shares, a right to payment equivalent to dividends and to vote on the shares).
- Fee paid by the securities borrower to the client = 2%–5% of the value of the securities borrowed.

- 12 This type of agreement is contemplated under a standard Australian Master Securities Lending Agreement (AMSLA) such as that published by the Australian Securities Lending Association (ASLA).

Regulation of arrangements that are not non-standard margin lending facilities

Proposal

- A1 We propose to maintain an active monitoring program in relation to products that fall outside the scope of the margin lending regulatory regime. We propose to use the intelligence from the monitoring program to inform any future decisions to declare a product to be a margin lending facility.

Your feedback

- A1Q1 Are there any other types of products/arrangements currently operating in the market, or which could likely commence operating, which you think we should address?

Rationale

- 13 Although an arrangement or facility may not meet the definition of ‘non-standard margin lending facility’, these products may nevertheless pose similar problems for retail clients in terms of understanding the product and its risks and benefits.
- 14 The margin lending regulatory regime gives ASIC power to declare that a particular kind of facility is, or is not, a margin lending facility. These powers are necessary to 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, to ensure that the relevant investor protection provisions continue to apply.

B Our proposal for disclosure for non-standard margin lending facilities

Key points

We propose to publish a regulatory guide outlining our expectations for improved disclosure to retail clients to help them understand and assess non-standard margin lending facilities.

We propose that the regulatory guide will build on the disclosure requirements for standard margin lending facilities under the Corporations Regulations, with the additional requirement to disclose certain key features and risks relevant to non-standard margin lending facilities.

Disclosure obligations for margin lending facilities

- 15 Standard margin lending facilities are subject to a tailored disclosure regime under the Corporations Regulations 2001 (Corporations Regulations).
- 16 This regime replaces the PDS content obligations in Part 7.9 of the Corporations Act. 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—the new short PDS should be sufficient disclosure on its own for a retail client 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.
- 17 We have not provided guidance to industry on compliance with the disclosure regime for standard margin lending facilities.
- 18 This consultation paper outlines our proposed approach to regulating disclosure in relation to non-standard margin lending facilities.

Proposal for regulatory guidance for providers of non-standard margin lending facilities

Proposal

- B1 We propose to publish a regulatory guide outlining our expectations for improved disclosure to retail clients to help them understand and

assess non-standard margin lending facilities (see the attached draft regulatory guide).

Your feedback

- B1Q1 Do you agree with the proposal to set out disclosure expectations in a regulatory guide? If not, why not?
- B1Q2 Should it apply to non-retail arrangements of the same type? If not, why not?

Rationale

- 19 Non-standard margin lending facilities will need to comply with the general content requirements for PDSs under Part 7.9. However, there are some content areas that we believe are essential if the PDS is to be fully effective in communicating the features and risks of the product.
- 20 Regulatory guidance will set out our expectations of what we believe is the key information that a retail client would need to know in order to make an informed decision to purchase the product.

Proposal for PDS content requirements for non-standard margin lending facilities

Proposal

- B2 We propose to require that the PDS for a non-standard margin lending facility disclose information about those issues that are addressed under the tailored regime for standard margin lending facilities and, in addition, the other key issues that are relevant to non-standard margin lending facilities, as outlined in Section B of the attached draft regulatory guide.

Your feedback

- B2Q1 Do you agree with the proposed approach of requiring disclosure of those issues covered in the tailored regime for standard margin lending facilities, plus additional disclosure of particular issues relevant to non-standard margin lending facilities, as outlined in Section B of the draft regulatory guide?
- B2Q2 Do you agree that the proposal covers the right issues specific to non-standard margin lending facilities? If not, what issues should or should not be addressed in the disclosure regime?

Rationale

- 21 Typically, a non-standard margin lending facility is not based on a loan agreement, but uses a type of securities lending agreement (with variations)

to achieve a similar economic outcome as would a standard margin lending facility.

- 22 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.
- 23 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). Non-standard margin lending facilities are typically marketed to retail clients as simple margin loan products, rather than as more complicated types of financial product.
- 24 Our proposal builds on 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.

C Regulatory and financial impact

- 25 In developing the proposals in this paper, we have carefully considered their regulatory and financial impact. On the information currently available to us we think they will strike an appropriate balance between:
- (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.
- 26 Before settling on a final policy, we will comply with the requirements of the Office of Best Practice Regulation (OBPR) by:
- (a) considering all feasible options;
 - (b) if regulatory options are under consideration, undertaking a preliminary assessment of the impacts of the options on business and individuals or the economy;
 - (c) if our proposed option has more than low impact on business and individuals or the economy, consulting with OBPR to determine the appropriate level of regulatory analysis; and
 - (d) conducting the appropriate level of regulatory analysis—i.e. completing a Business Cost Calculator report (BCC report) and/or a Regulation Impact Statement (RIS).
- 27 All BCC reports and RISs are submitted to the OBPR for approval before we make any final decision. Without an approved BCC report and/or RIS, ASIC is unable to give relief or make any other form of regulation, including issuing a regulatory guide that contains regulation.
- 28 To ensure that we are in a position to properly complete any required BCC report or RIS, we ask you to provide us with as much information as you can about:
- (a) the likely compliance costs;
 - (b) the likely effect on competition; and
 - (c) other impacts, costs and benefits,
- of our proposals or any alternative approaches: see ‘The consultation process’, p. 4.



ASIC

Australian Securities & Investments Commission

REGULATORY GUIDE 000

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

December 2009

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 retail clients understand and assess these facilities.

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 draft regulatory guide was issued on 21 December 2009 and is based on legislation and regulations as at 21 December 2009.

Disclaimer

This draft 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 draft guide are purely for illustration; they are not exhaustive and are not intended to impose or imply particular rules or requirements.

At the date of issue of this draft guide:

- the margin lending amendments made by the *Corporations Legislation Amendment (Financial Services Modernisation) Act 2009* had not commenced; and
- the amendments to the Corporations Regulations proposed to be made as a consequence of that Act were in exposure draft form and therefore subject to change before being made final.

Once the amendments to the regulations are made final, we will update our guidance if necessary.

DRAFT

Contents

A	Background	17
	Who does this guide apply to?	17
	Underlying principles	18
B	Our expectations for disclosure	20
	Disclosure regime for standard margin lending facilities	21
	Disclosure regime for non-standard margin lending facilities	22
	Disclosure of other features.....	24
	Key terms	25
	Related information	27

DRAFT

A Background

Key points

The *Corporations Legislation Amendment (Financial Services Modernisation) Act 2009* regulates margin lending facilities as financial products under Ch 7 of the Corporations Act. Standard margin lending facilities are subject to a tailored disclosure regime under the Corporations Regulations 2001.

This guide sets out our expectations for disclosure by providers of non-standard margin lending facilities.

Who does this guide apply to?

RG 000.1 This guide applies to a provider of a non-standard margin lending facility.

What is a non-standard margin lending facility?

RG 000.2 The *Corporations Act 2001* (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;
- (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: s761EA(5).

- RG 000.3 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 000.4 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 000.5 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). Although the legal structure of a non-standard margin lending facility is different to that of a standard margin lending facility, both types are typically marketed to retail clients as 'margin loan' products.
- RG 000.6 In addition to 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 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, to ensure that the relevant investor protection provisions continue to apply to these products.

Underlying principles

- RG 000.7 The disclosure framework in the 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 000.8 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 000.9 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.

DRAFT

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 000.10 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 000.11 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.

DRAFT

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 000.16–RG 000.19);
- the additional key features of a non-standard margin lending facility, as outlined at RG 000.20–RG 000.22; and
- any additional key issues that would influence a retail client’s decision to purchase the product (see RG 000.23).

- RG 000.12 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. The items set out below 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 items supplement, but do not remove, the requirement to comply with the PDS content requirements under s1013D and Pt 7.9 generally.
- RG 000.13 This guide sets 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.
- RG 000.14 Our expectations reflect the content requirements identified by the 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 000.15 In relation to ongoing disclosure, our expectations will reflect the same principles that we set out in this guide for PDS disclosure regarding the risks and features of a non-standard margin lending facility that a retail client should be made aware of.

Disclosure regime for standard margin lending facilities

RG 000.16 The Australian Government has developed a tailored disclosure regime for standard margin lending facilities. This regime is set out in proposed Sch 10C of the Corporations Regulations 2001 (Corporations Regulations).

RG 000.17 This regime replaces the PDS content obligations in Pt 7.9 of the Corporations Act. 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 000.18 In summary, the Corporations Regulations provide that a PDS for a standard margin lending facility must include:

- (a) an explanation 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 borrowers need to regularly monitor their portfolio; and
 - (iii) a statement that borrowers may need, at short notice, to pay an additional amount into the margin loan or sell some of the investments and a statement that borrowers may need to access other funds to repay the margin loan if the value of the portfolio does not cover repayment of the loan;
- (b) the key benefits available from a margin loan;
- (c) an explanation of how margin lending works, including explanations of the maximum loan amount and the LVR, and what financial products (or types of financial product) borrowers can purchase with the borrowed funds;
- (d) an explanation of what a margin call is, how and when the borrower will be notified of a margin call, the consequences of a margin call and what the borrower would have to do in the event of a margin call;
- (e) a description of prescribed key risks associated with margin lending, including:
 - (i) the risk that the value of borrowers’ investments might fall and the possible consequences—in particular, the risk of a margin call if the gearing level rises above the LVR;
 - (ii) the risk that the lender may change the LVR of any given investment and the possible consequences—in particular, the risk of a margin call occurring if the gearing level rises above the LVR;

- (iii) the risk that the lender may remove any given investment from the Approved Product List and the possible consequences—in particular, the risk of a margin call occurring if the gearing level rises above the LVR;
- (iv) where applicable, the risk that the interest rate may rise and the consequences—in particular, the possibility that interest payments may exceed the returns available from the investment portfolio; and
- (v) the risk that tax laws can change, and possibly have a negative impact on a borrower's tax position; and
- (f) a description of the costs of the product.

Note: See proposed Sch 10C of the Corporations Regulations.

RG 000.19 Further guidance on these issues is provided in the commentary to the Exposure Draft Corporations Amendment Regulations released by Treasury in September 2009.

Disclosure regime for non-standard margin lending facilities

RG 000.20 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 000.18) 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 000.21 In addition to those items above, 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 must 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 (e.g. 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

DRAFT

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 there are no equivalent securities available;
- (f) 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 the payment of an additional amount of transferred property; and
- (g) 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 000.22 Disclosure of these matters must be prominent.

DRAFT

Disclosure of other features

RG 000.23 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> , as amended by Schedule 1 of the Modernisation Act, including regulations made for the purposes of the 2001 Act
Corporations Regulations	Corporations Regulations 2001, as proposed to be amended by Exposure Draft Corporations Amendment Regulations released by Treasury in September 2009
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; or • 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; or • 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
Modernisation Act	<i>Corporations Legislation Amendment (Financial Services Modernisation) Act 2009</i>
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

Margin lending, non-standard margin lending facilities, product disclosure statement

Legislation

Australian Securities and Investments Commission Act 2001

Corporations Act, Pt 7.9; Corporations Regulations

Corporations Legislation Amendment (Financial Services Modernisation) Act 2009