



ASIC

Australian Securities & Investments Commission

REPORT 177

Response to submissions on CP 109 Margin lending: Financial requirements

December 2009

About this report

This report highlights the key issues that arose out of the submissions received to Consultation Paper 109 *Margin lending: Financial requirements* (CP 109) and details our response to those issues.

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.

Disclaimer

This report 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.

This report does not contain ASIC policy. Please see Regulatory Guide 166 *Licensing: Financial requirements* (RG 166) and Consultation Paper 109 *Margin lending: Financial requirements* (CP 109).

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A Overview/Consultation process

- 1 Under the *Corporations Legislation Amendment (Financial Services Modernisation) Act 2009*, a provider of financial services in relation to a margin lending facility will be required to obtain an Australian financial services (AFS) licence and will be subject to the conduct obligations in Ch 7 of the *Corporations Act 2001* (Corporations Act), including the obligation to have adequate financial resources.
- 2 In Consultation Paper 109 *Margin lending: Financial requirements* (CP 109), ASIC consulted on the financial resource requirements we should impose on the holder of an AFS licence (AFS licensee) who provides a financial service in relation to a margin lending facility.
- 3 CP 109 proposed that the financial requirements in RG 166 *Licensing: Financial requirements* (RG 166) should apply to AFS licensees who provide financial services in relation to a margin lending facility subject to amendments so that:
 - (a) the base level requirements set out in Section B of RG 166 will apply to an AFS licensee who provides a financial service in relation to a margin lending facility;
 - (b) the net tangible asset (NTA) requirement in Section C of RG 166 will apply to an issuer of a margin lending facility;
 - (c) an AFS licensee who holds secured property on trust for the client, or has the power to dispose of the client's property under a margin lending facility, will be required to comply with the surplus liquid funds (SLF) requirement in Section E of RG 166;
 - (d) the adjusted surplus liquid fund (ASLF) requirement in Section F of RG 166 will apply to an AFS licensee who issues a non-standard margin lending facility; and
 - (e) the ASLF requirement will not apply if an issuer agrees to provide credit under a margin lending facility and the credit remains undrawn or is drawn down in tranches.
- 4 This report highlights the key issues that arose out of the submissions received to CP 109 and our response to those issues.
- 5 For a list of the non-confidential respondents to CP 109, see the Appendix to this report. Copies of the submissions are on the ASIC website at www.asic.gov.au/cp under CP 109.

Responses to consultation

- 6 We received four responses to CP 109 from relevant industry bodies and a law firm. We are grateful to the respondents for taking the time to send us their comments.
- 7 Responses were largely supportive of the proposals in CP 109. The submissions were either unqualified in their support, qualified in some respect or sought clarification on the application of a particular proposal.
- 8 Most respondents provided feedback on only a small number of key issues of particular concern to them. One respondent provided feedback on all proposals.
- 9 The main issues raised by respondents related to:
- (a) the scope of the regime and who would be subject to it; and
 - (b) whether the compliance obligations should be more prescriptive.
- 10 We have limited this report to these key issues rather than providing a comprehensive summary of all responses received or every question posed for feedback in CP 109.

B Who should be subject to the requirements in RG 166?

Key points

In CP 109, we proposed that AFS licensees who provide a financial service in relation to a margin lending facility should be subject to the financial requirements in RG 166 (with some exemptions).

Some respondents suggested we should also exempt:

- a subsidiary or a related body corporate of an authorised deposit taking institution (ADI) from the financial resource requirements in RG 166
- an AFS licensee who provides advice in relation to a margin lending facility from the surplus liquid fund (SLF) requirement in Section E of RG 166.

Should subsidiaries of ADIs be excluded?

- 11 Under s912A(1)(d) of the Corporations Act, an ADI is exempt from the financial resource requirements in RG 166 because it is regulated by APRA. One respondent recommended that a subsidiary or a related body corporate of an ADI should also be exempt from the requirement to maintain adequate financial resources to provide financial services in relation to a margin lending facility.

ASIC's response

A subsidiary or a related body corporate of an ADI is exempt from the cash needs requirement in Section B of RG 166 if the subsidiary or the related body corporate has a reasonable expectation of financial support from an ADI. Otherwise, a subsidiary or a related body corporate of an ADI will be subject to the financial resource requirements in RG 166, unless it is also regulated by APRA.

We do not believe that it is appropriate to extend the exemption for ADIs to the subsidiary of an ADI because the financial capacity of the subsidiary may not be material to APRA's purpose in regulating the ADI: see RG 166.6.

Should advisers be excluded from the surplus liquid fund (SLF) requirement?

- 12 We proposed that the requirement in Section E of RG 166 to hold at least \$50,000 in surplus liquid funds should apply to issuers and advisers of margin lending facilities without amendment. There was general support for this proposal.
- 13 However, one respondent supported applying the SLF requirement to issuers of margin lending facilities but not to advisers.

ASIC's response

We have decided to apply the SLF requirements to AFS licensees who issue or advise on margin lending facilities without amendment.

The SLF requirement ensures that an AFS licensee has a buffer of liquid assets to safeguard against the risk that client property may be applied to meet the licensee's financial obligations, rather than being held in accordance with its duties to the client.

Depending on its arrangements with clients, this risk may be equally applicable to an AFS licensee who provides advice in relation to a margin lending facility. Therefore we believe it is appropriate to apply this requirement to both issuers and advisers.

C Compliance obligations

Key points

In CP 109, we proposed to apply the base level financial requirements in Section B of RG 166 to AFS licensees who provide financial services in relation to a margin lending facility.

One respondent recommended that we impose more prescriptive compliance obligations for these requirements.

Should we impose more prescriptive compliance obligations?

- 14 One respondent suggested that our proposal to apply the base level requirements in Section B of RG 166 could be more prescriptive in terms of the compliance obligations ASIC imposes on AFS licensees (e.g. by prescribing a compliance framework).
- 15 The respondent sought clarification on whether the requirements in Section B of RG 166 only imposed an obligation to provide ASIC with an audit report about compliance with the financial requirements. The respondent recommended that rather than relying solely on audit activities, ASIC should provide guidance on what would constitute an adequate compliance framework and make reference to breach reporting obligations.

ASIC's response

We do not believe that more prescriptive compliance obligations are appropriate. Such an approach would be incompatible with our policy in Regulatory Guide 104 *Licensing: Meeting the general obligations* (RG 104) not to impose prescriptive guidance on compliance obligations.

RG 104 sets out key compliance concepts and what ASIC looks for when assessing compliance with the general licence obligations under s912A(1), including adequate financial resources. In RG 104, we seek to strike a balance between certainty and flexibility. Our policy is that the general obligations are principles-based and designed to apply in a flexible way. For this reason, we do not give prescriptive guidance on what an AFS licensee needs to do to comply with them: see RG 104.7.

We believe that the compliance obligations are adequately dealt with in Section A of RG 166 and more generally in RG 104. Section A of RG 166 provides guidance on risk management systems and breach reporting obligations. These requirements will apply to an AFS licensee who provides a financial service in relation to a margin lending facility.

Appendix: List of non-confidential respondents

- Australian Bankers' Association
 - Australian Compliance Institute
 - McCullough Robertson Lawyers
 - Securities & Derivatives Industry Association
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