



**ASIC**

Australian Securities & Investments Commission

## REGULATION IMPACT STATEMENT

# ASIC implementation of the national margin lending regime

December 2009

### About this Regulation Impact Statement

This Regulation Impact Statement (RIS) addresses ASIC's proposals for new/amended regulatory obligations for Australian Financial Services (AFS) licensees in relation to the national margin lending regime. To the extent that ASIC's existing policy and guidance is relevant to licensees in relation to margin loans, it will continue to apply. The specific issues where ASIC has taken action to implement new regulatory requirements for licensees in relation to margin lending are:

- minimum training standards for advisers; and
- financial resource requirements.

## What this Regulation Impact Statement is about

- 1 This Regulation Impact Statement (RIS) addresses ASIC's proposals for new/amended regulatory obligations for AFS licensees in relation to the national margin lending regime.
- 2 To the extent that ASIC's existing policy and guidance is relevant to licensees in relation to margin loans, it will continue to apply. The specific issues where ASIC has taken action to implement new regulatory requirements for licensees in relation to margin lending are:
  - (a) minimum training standards for advisers;
  - (b) financial resource requirements.
- 3 In developing our final position, we have considered the regulatory and financial impact of our proposals. We aim to strike an appropriate balance between:
  - maintaining, facilitating and improving the performance of the financial system and entities in it;
  - promoting confident and informed participation by investors and consumers in the financial system; and
  - administering the law effectively and with minimal procedural requirements.
- 4 This RIS sets out our assessment of the regulatory and financial impacts of our proposed policy and our achievement of this balance. It deals with:
  - the likely compliance costs;
  - the likely effect on competition; and
  - other impacts, costs and benefits.

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# Introduction

## Background

### The new margin lending regulatory regime

5 As a result of the *Corporations Legislation Amendment (Financial Services Modernisation) Act 2009*, margin lending facilities are regulated as financial products in Chapter 7 of the Corporations Act. This means that a person providing a financial service in relation to a margin lending facility will be subject to a comprehensive range of licensing, conduct and disclosure requirements, including requirements to:

- (a) have an Australian Financial Services Licence (AFSL);
- (b) do all things necessary to ensure that the financial services covered by the licence are provided efficiently, honestly and fairly;
- (c) have appropriate compensation arrangements in place for losses suffered by retail clients due to breaches of the law;
- (d) be members of an ASIC approved external dispute resolution (EDR) scheme;
- (e) provide disclosure to their clients before and after a product is purchased, including providing a product disclosure statement (PDS), a statement of advice (SOA) and periodic statements on an ongoing basis;
- (f) have in place adequate arrangements for the management of conflicts;
- (g) ensure that they (and their employees) have adequate resources and are competent to provide the services;
- (h) be subject to the enforcement provisions surrounding market manipulation, false or misleading statements, inducing investors to deal using misleading information, and engagement in dishonest, misleading or deceptive conduct.

### Regulatory impact of the new margin lending regime

6 The regulatory impact of the obligations established under the new margin lending regime was assessed in the RIS attached to the Explanatory Memorandum to the Corporations Legislation Amendment (Financial Services Modernisation) Bill 2009.

7 In summary, that RIS found:

- (a) the groups affected by the new regime for margin loans would be consumers of credit; industry participants including lenders and advisers; and the Government/ASIC.
- (b) most of the participants (as lenders or providers) engaging in the margin lending market would already be familiar with the Chapter 7 obligations as they also supply and deal in other financial products that are covered by the Chapter 7 framework.
- (c) it is estimated that there are between 1,000 to 2,000 financial planners active in margin loans, though many would already be covered by Chapter 7 with respect to their other business lines.
- (d) the number of lenders is much smaller, and is estimated not to exceed 15. Most lenders are ADIs which are already in possession of an AFSL for other parts of their business.

### What this RIS is about

- 8 This RIS assesses the regulatory impact of ASIC's proposals associated with implementation of the new margin lending regime. It does not deal with the decision to make margin loans a financial product for the purposes of Chapter 7 of the Corporations Act, as this is an obligation imposed under the *Corporations Legislation Amendment (Financial Services Modernisation) Act 2009*. Rather, this RIS assesses the regulatory impact of those decisions within ASIC's discretion which are necessary for implementation of the *Corporations Legislation Amendment (Financial Services Modernisation) Act 2009* by ASIC.
- 9 To the extent that ASIC's existing policy and guidance is relevant to licensees in relation to margin loans, it will continue to apply. The specific issues where ASIC has taken action to implement new regulatory requirements for licensees in relation to margin lending are:
  - (a) minimum training standards for advisers;
  - (b) financial resource requirements.

### Assessing the problem

- 10 Although the Corporations Act imposes a number of obligations on people who are required to obtain an AFSL, these obligations are expressed as high-level principles. For example, in relation to training, the law requires that licensees ensure that their representatives are adequately trained, and are competent, to engage in the activities authorised by the licence. However the law provides no standards or guidance as to what "adequate" training means.

- 11 Taking no action would cause confusion for industry in determining the behaviour required in order to comply with the law. This lack of clarity also poses a risk to consumers if licensees' confusion results in them behaving in a way which is adverse to consumer confidence.
- 12 Regulatory intervention in the form of regulatory guidance is needed to correct the problem because of the principles-based nature of the current law. While it may be possible that, in general, competition among licensees to improve their reputation may push up standards to a level which achieves appropriate consumer protection, the particular issues covered in this RIS (ie training/competence, financial resource requirements) are not key issues on which consumers make their purchasing or investment decisions, so are unlikely to have a significant effect on competitive pressures in the market.

## Objectives of government action

- 13 The proposals in this RIS seek to balance ASIC's objectives to:
- (a) maintain, facilitate and improve the performance of the financial system and entities in it;
  - (b) promote confident and informed participation by investors and consumers in the financial system; and
  - (c) administer the law effectively and with minimal procedural requirements.
- 14 Additional, specific objectives relating to each issue covered in this RIS are addressed in the relevant parts below.

## Consultation

- 15 In considering its approach to the issues addressed in this RIS, ASIC released two consultation papers:
- (a) Consultation Paper 108 *Margin lending: Training of financial advisers* (CP 108);
  - (b) Consultation Paper 109 *Margin lending: Financial requirements* (CP 109).
- 16 Details of consultation on each issue will be addressed in each part below.

## A Minimum training standards for advisers

- 17 This section considers options in relation to setting minimum training standards for advisers that provide advice on margin lending facilities ('margin lending advisers').

### Assessing the problem

- 18 Once margin lending facilities are regulated under Ch 7 of the Corporations Act, AFS licensees who provide financial services relating to margin lending facilities will be subject to the general licensee obligations. This includes the obligations to:
- (a) maintain the competence to provide the financial services covered by the licensee's licence: s912A(1)(e); and
  - (b) ensure that representatives are adequately trained, and are competent, to provide those financial services: s912A(1)(f).

### Current approach

- 19 ASIC has previously set minimum standards for the training of financial product advisers in Regulatory Guide 146 *Licensing: Training of financial product advisers* (RG 146). These apply to all natural persons who provide financial product advice to retail clients. The standards set in RG 146 give concrete meaning to the legal obligations to be competent and adequately trained. For example, RG 146 specifies particular qualifications that must be completed in order for an adviser to provide financial product advice on particular types of products.
- 20 Under our policy on training requirements, products are divided into two groups—Tier 1 and Tier 2. The former category comprises products that are more complex than the latter.
- 21 For example, current Tier 1 products include managed investments, superannuation, securities and derivatives. These products all share the characteristic of having a strong investment component, and this exposure to market volatility increases the risks associated with them, and will therefore not be suitable for all consumers. On the other hand, current Tier 2 products, which include simpler banking and non-cash payment facility products (e.g. stored value cards, direct debit facilities) are not exposed to market volatility to the same extent. Tier 1 products also tend to have more complex fee structures than Tier 2 products.

- 22 To ensure that consumers receive quality advice on Tier 1 products, advising on Tier 1 products attracts a more onerous training standard than advising on Tier 2 products. An adviser who provides advice on Tier 1 products must undertake:
- (a) training in generic knowledge of the environment in which the products operate; and
  - (b) specialist knowledge training on the financial products on which advice is provided.

An adviser who provides advice on Tier 2 products is only required to undertake specialist knowledge training relating to the product/s on which they provide advice.

- 23 Generally, the program content of Tier 1 courses is also set at a more advanced level than for Tier 2 courses (Tier 1 courses are at the ‘Diploma’ level under the Australian Qualifications Framework; Tier 2 courses are equivalent to the Certificate III level).
- 24 If an adviser provides personal advice, they are also required to complete approved training courses covering relevant skill requirements (e.g. establishing a relationship with the client, and identifying and analysing the client’s objectives, needs, financial situation and risk profile).
- 25 Training courses may be delivered by registered training organisations, self-accrediting organisations (i.e. universities and higher education institutions) and professional and industry associations that have been accredited by ASIC. Generally, courses must be registered on the ASIC Training Register, with some limited exceptions. Most advisers, therefore, will need to undertake a course from the ASIC Training Register.

## Problems

- 26 ASIC considers that the absence of explicit guidance on training standards for margin lending advisers is problematic in two key respects:
- (a) this absence of guidance may lead to confusion, firstly, for advisers, as to how they can meet their training obligations, and, secondly, for those who provide the bulk of training to advisers (i.e. training providers, and professional and industry associations) in determining what training they may offer advisers to assist them to meet their regulatory requirements; and
  - (b) there is a risk that retail clients seeking advice on margin lending facilities may receive advice from persons that are not sufficiently competent to provide that advice.

**Confusion among advisers, training providers and industry and professional bodies**

- 27 As margin lending has not previously been regulated under the Corporations Act, earlier versions of RG 146 have not set out any training standards for advisers who provide advice to retail clients on margin lending facilities.
- 28 Based on ASIC's regulatory experience and feedback to consultation, advisers rely heavily on RG 146, as read in combination with the Financial Services Training Package (FSTP), to understand what they must do to meet their training obligations. If ASIC does not update RG 146 to specify how our training standards apply to margin lending, there may be considerable confusion among affected advisers as to how they can meet their training obligations in relation to margin lending.
- 29 If no amendment is made to RG 146, margin lending facilities will fall into the catch-all Tier 2 category; however, RG 146 would not provide any further guidance relating to training requirements for margin lending facilities, as it does for other Tier 2 products. In the absence of specific guidance, training providers and professional and industry associations may also find it difficult to understand what training they can offer advisers that will assist them to meet their regulatory requirements.

**Risk of poor advice**

- 30 ASIC has previously set minimum standards for the training of financial product advisers as we have identified a specific need to ensure that those who provide advice are sufficiently competent. This is particularly so where advice is provided to retail clients, who often do not have adequate resources or expertise to assess whether a particular adviser has an appropriate level of competence to provide financial advice.
- 31 If ASIC does not set minimum training standards in relation to margin lending facilities, this may mean that some advisers providing advice in this area may not have completed appropriate training to ensure that they are fully competent to provide that advice.
- 32 Given that the Government has identified the need to increase the regulation of margin lending through deeming margin lending facilities to be financial products, it would be inconsistent with this overall policy aim for ASIC not to consider what training standards should apply to advisers who provide advice on margin lending facilities.
- 33 From our own regulatory experience, we are concerned that there are particular risks associated with margin lending, in relation to which consumers require sound advice from an appropriately trained adviser. For example, a consumer investing through a margin loan is generally required to ensure that their portfolio stays at a certain 'loan-to-value' ratio (i.e. the

proportion of money outstanding on the loan in relation to the value of the portfolio). If the value of the portfolio decreases due to a fall in the market, the consumer may be required to sell some of their portfolio to restore the loan-to-value ratio. In a highly volatile market, it is possible that the value of a portfolio could decrease to such an extent that it is not sufficient to repay the balance of the loan.

- 34 We think that, because margin lending facilities are potentially subject to such risks, consumers require high quality financial advice to decide whether to invest through a margin lending facility, and how best to manage it if they do.

## Objectives

- 35 The aims of ASIC's proposals in this area are to:
- (a) protect retail clients who seek and obtain financial product advice in relation to margin lending facilities by ensuring that those who provide the advice are sufficiently competent to do so;
  - (b) help advisers to understand how they can comply with their legal obligations in relation to competency and training, where those advisers intend to provide advice on margin lending facilities; and
  - (c) help training and education providers and professional and industry associations understand ASIC's regulatory requirements in relation to margin lending, so that they can develop appropriate training courses and standards.

## Options

- 36 Possible options are:
- Option 1: Treat margin lending facilities as a Tier 1 product;
  - Option 2: Treat margin lending facilities as Tier 2 products; and
  - Option 3: Status quo.

## Impact analysis

### Option 1: Treat margin lending facilities as a Tier 1 product

#### Description of option

- 37 Under this option, advisers who advise on margin lending facilities would be subject to the full Tier 1 training requirements. This will mean that they will need to complete the following training:
- (a) generic knowledge training about the economic environment; and
  - (b) specialist knowledge training on the actual features of margin lending facilities and margin lending as an investment strategy, the broad content of which would be set out in RG 146; and
  - (c) if the adviser provides advice on underlying investments through the margin lending facility, other specialist knowledge training in relation to other products on which advice is provided (as already set out in RG 146, Appendices A2.1–A2.9); and
  - (d) if the adviser provides personal advice, skills training that complies with Appendix B of RG 146.
- 38 In relation to the specialist knowledge requirements ASIC would set, this would be in a similar format to that mandated for other products for which specialist knowledge is mandated in RG 146, that is:
- (a) ASIC would include a new table setting out all of the areas of knowledge that an appropriate course would need to cover in order for an adviser undertaking that course to be deemed to have acquired the requisite specialist knowledge.
  - (b) This would cover:
    - (i) The different types of margin lending products available, and the particular characteristics and the risks associated with each. This component would need to cover aspects of margin lending facilities that have been of particular concern to ASIC, that is, margin calls, and how a client may best avoid them.
    - (ii) Taxation issues relevant to margin lending, to provide the adviser with a good understanding of the broader context of margin lending as an investment strategy.
    - (iii) Relevant regulatory requirements (e.g. Corporations Act requirements), ASIC policy and industry codes of conduct.
    - (iv) Theories of investment, portfolio management and management of investment and risk as they specifically relate to margin lending (e.g. the importance of being aware of the client's risk profile and financial situation, the source and stability of source of the funding

for the investment, and particular client risk profiles that may be unsuited to margin lending facility products).

39 As with current financial products for which ASIC has set specialist knowledge requirements, by setting this content, this will enable the development of courses of an adequate standard according to the following process:

- (a) Innovation and Business Skills Australia (IBSA), the body responsible for developing and maintaining the Financial Services Training Package, can use ASIC's specialist knowledge content as a starting point to develop guidelines as to what a course relating to margin lending should cover, and what other courses an adviser should study in conjunction with this in order to gain a rounded knowledge of the area.
- (b) Course providers can then use IBSA's guidelines to develop courses at the standard we expect.

#### **Impact on industry**

40 Those in industry that would be particularly affected by this option are:

- advisers that provide financial product advice to retail clients; and
- bodies that provide training to AFS licensees (i.e. training providers, and professional and industry associations).

#### *AFS licensees*

41 For margin lending advisers, this option would give a degree of certainty as to how they can meet their legal obligations under s912A. We think that this will be of great assistance to advisory firms in planning their training programs.

42 However, treating margin lending facilities as Tier 1 products will also involve the imposition of costs. The costs incurred per adviser would differ according to whether the adviser is new to the industry, or whether they had already been providing advice for some time, as summarised in Table 1. The RIS for the Corporations Legislation Amendment (Financial Services Modernisation) Bill 2009 estimates the number of current advisers active in margin loans to be between 1000–2000. It is difficult to estimate the numbers of new advisers that will enter the sector, either at the commencement of the new legislation, or in the succeeding years.

**Table 1: Estimated training costs for advisers of differing levels of experience**

Level of experience	Training required	Estimated costs
<b>New advisers</b>	<p>These advisers would need to undertake all of the training outlined at paragraph 37.</p> <p>Treating margin lending facilities as Tier 1, rather than Tier 2 products (Option 2) will mean that advisers must undertake this training at a higher level than they would for Tier 2 training (i.e. at Diploma, rather than Certificate III level), involving more time and higher training fees.</p>	<p>Submissions to CP 108 estimated the costs of this training as being anywhere between \$1600–\$5000 per adviser, although submissions did not provide details as to how these estimates were reached.</p>
<b>Current advisers</b>	<p>Most advisers whose clients currently use margin lending facilities will already be AFS licensees or representatives. They are likely to have already undertaken:</p> <ul style="list-style-type: none"> <li>• generic knowledge training as part of their licensing requirements, as they will have been providing advice on the Tier 1 products their clients have acquired through margin lending facilities (e.g. securities, derivatives, interests in managed investment schemes) for some time already; and</li> <li>• the product-specific specialist knowledge training relating to each of these products.</li> </ul> <p>Therefore, for these advisers the only remaining training to complete their full training requirements will be specialist knowledge training on the features of margin lending.</p>	<p>Costs incurred are likely to be much lower than for new advisers.</p> <p>A leading course provider, Kaplan, has estimated that a course satisfying the knowledge requirements for margin lending would cost around \$350 per participant.</p>
<b>Very experienced advisers</b>	<p>Under the current policy settings in RG 146, sufficiently experienced advisers (i.e. with 5 years' relevant industry experience in the past eight years) can apply to be individually assessed as already meeting the training requirements by an authorised assessor (i.e. a registered training organisation or professional or industry body relevant to the financial services industry approved by ASIC).</p> <p>In addition, current advisers who have completed a training course that is not listed on the ASIC Training Register, but which they believe meets the knowledge requirements for margin lending, may apply to have the course accredited by an authorised assessor.</p>	<p>There are costs associated with individual assessment, including time taken from work, and fees charged by the assessor. Kaplan currently provides individual assessment services at rates ranging from \$130–\$365 per assessment, depending on the time required to be spent with the adviser.</p> <p>If successful through individual assessment, an adviser will be deemed to have met the training requirements for margin lending, and will not need to undertake a new training course. The time and cost associated with individual assessment is likely to be lower than completing either the full training requirements, or only training specific to margin lending.</p>

43

Generally, costs are likely to rise in direct proportion with the number of advisers that will require training at each firm. However, larger firms, with

more advisers, may be able to negotiate discounted rates with training providers, and may have a greater ability to absorb any implementation costs (e.g. renewing and updating training policies and procedures).

- 44 The nature of the legal obligations relating to competency and training for AFS licensees and representatives means that advisers will need to undertake continuing training every year that they remain in the industry, to ensure that they continue to remain sufficiently competent once they have undertaken their initial training. RG 146 does not specify particular requirements for continuing training, other than to note that AFS licensees are subject to ongoing obligations to maintain competence and ensure that representatives are adequately trained, and to state that licensees can meet these obligations by establishing training policies and procedures. This would apply equally to margin lending advisers, and there would be ongoing costs associated with implementing and running continuing training programs.

*Training course providers and industry and professional associations*

- 45 Training course providers and industry and professional associations may incur some initial costs in developing courses and applying to ASIC for recognition of those courses, or for recognition of the body itself as an authorised assessor. However, in the longer-term, these bodies are likely to generate increased revenue due to the increased demand for training in this area, and this is likely to be greater than any implementation costs incurred.

**Impact on consumers**

- 46 The RIS accompanying the margin lending aspects of the Corporations Legislation Amendment (Financial Services Modernisation) Bill 2009 identified concerns with margin lending, including that some borrowers have entered into margin loan arrangements without fully understanding the risks specific to margin lending (these specific risks are described in paragraph 33 of this Statement). The RIS accompanying the Bill states that the objective of the new regulation of margin lending under the Corporations Act is to ensure that retail investors who enter into margin lending arrangements are fully aware of the associated risks, and do not enter into margin loans due to irresponsible conduct by lenders and/or inappropriate advice by financial advisers.
- 47 Setting minimum training standards for margin lending advisers would improve the quality of the advice provided to retail clients by ensuring that advisers have undertaken training that includes information on the key features and risks of margin lending. Categorising margin lending facilities as Tier 1, rather than Tier 2, products is particularly important in this respect, as Tier 1 training is undertaken at a more advanced level, and includes generic knowledge training on the economic environment and relevant market knowledge. The latter is particularly important to ensure that advisers

have a full knowledge of all matters relevant to the product, as margin lending facilities have a crucial investment component, and generic knowledge of market conditions is very important to an overall understanding of the product and the context in which it operates.

- 48 This option would not impose any direct costs on consumers. However, depending on the costs incurred by each firm, some of these costs might eventually be passed on to consumers in the form of increased fees (if the firm provides advice on a fee basis).

#### Impact on government

- 49 To implement this option, ASIC would need to update and re-release RG 146, to include a new section on specialist knowledge for margin lending. ASIC has already received additional funding from Government to assist it to carry out policy work associated with the new regulation of margin lending and consumer credit, and would not apply for further funding in relation to this work.

#### Impact table

- 50 Table 2 summarises the benefits and costs associated with this option, using the numerical scale set out in Table 3 to evaluate each individual impact.

**Table 2: Option 1—Impact analysis**

	Benefits	Costs
Consumers	Significantly greater likelihood of receiving advice from advisers who are sufficiently competent and trained to provide that advice. (+3)	Costs of receiving advice may increase as industry passes on higher training costs. (-1)
Industry	<p><b>AFS licensees:</b></p> <p>Increased certainty from being provided with detailed minimum training standards for margin lending advisers, which will assist in the transition to regulation under Ch 7. (+ 1)</p> <p><b>Training course providers and industry and professional associations:</b></p> <p>Increased demand for training. (+3)</p>	<p><b>AFS licensees:</b></p> <p>Transitional and ongoing costs in completing the training requirements and maintaining competency. (- 3)</p> <p><b>Training course providers and industry and professional associations:</b></p> <p>Transitional costs in developing and providing courses. (- 1)</p>
Government	Reduced incidence of consumer complaints requiring ASIC assistance. (+ 1)	Transitional and ongoing costs of developing and enforcing new training standards for margin lending. (- 1)
Sub-rating	+ 8	-6
Overall rating		+ 2

**Table 3: Rating scale for individual impacts**

+3	+2	+1	0	-1	-2	-3
Large benefit/ advantage compared to 'do nothing'	Moderate benefit/ advantage compared to 'do nothing'	Small benefit/ advantage compared to 'do nothing'	No substantial change from 'do nothing'	Small cost/ disadvantage compared to 'do nothing'	Moderate cost/ disadvantage compared to 'do nothing'	Large cost/ disadvantage compared to 'do nothing'

## Option 2: Treat margin lending facilities as Tier 2 products

### Description of option

51 Under this option, margin lending advisers would need to undertake, at the Tier 2 level:

- (a) specialist knowledge training on the actual features of margin lending facilities and margin lending as an investment strategy, the broad content of which would be set out in RG 146; and
- (b) if the adviser provides personal advice, skills training that complies with Appendix B of RG 146.

Tier 2 studies are broadly equivalent to the 'Certificate III' level, rather than the more advanced 'Diploma' level required for Tier 1 studies.

52 Advising on margin lending facilities would not of itself trigger a requirement to undertake the generic knowledge training, although, to the extent to which advisers give advice covering Tier 1 products acquired through the margin lending facility (e.g. securities, derivatives or managed investments), advisers will still need to have undertaken, at the Tier 1 level:

- (a) generic knowledge training about the economic environment (Appendix A1 of RG 146); and
- (b) specialist knowledge training in relation to the products about which advice is provided (Appendix A2.1–A2.9 of RG 146).

### Impact on industry

53 Those in industry that would be particularly affected by this option are:

- advisers that provide financial product advice to retail clients; and
- bodies that provide training to AFS licensees (i.e. training providers, and professional and industry associations).

#### *AFS licensees*

54 For margin lending advisers, as for Option 1, this option would give a degree of certainty as to how they can meet their legal obligations under s912A. We

think that this will be of great assistance to advisory firms in planning their training programs.

55 We did not receive any information relating to the likely costs of implementing this option in submissions to CP 108. However, we estimate that the direct training costs associated with this option would vary according to the level of experience of the adviser, as for Option 1; however, overall, they could be slightly lower than for Option 1, as:

- (a) there would be no requirement for advisers to undertake generic knowledge training to provide advice on margin lending facilities (although as discussed above, they would still need to undertake this training if they also provide advice on Tier 1 products); and
- (b) undertaking training at the less advanced Certificate III level would involve less time and cost than undertaking training at the Tier 1 Diploma level.

56 As for Option 1, the nature of the legal obligations relating to competency and training for AFS licensees and representatives mean that advisers will need to undertake continuing training every year that they remain in the industry, to ensure that they continue to remain sufficiently competent once they have undertaken their initial training, and there would be ongoing costs associated with implementing and running continuing training programs.

*Training course providers and industry and professional associations*

57 Training course providers and industry and professional associations may incur some initial costs in developing courses and applying to ASIC for recognition of those courses, or for recognition of the body itself as an authorised assessor. However, in the longer-term, these bodies are likely to generate increased revenue due to the increased demand for training in this area, and this is likely to be greater than any implementation costs incurred. The revenue associated with this option could be slightly lower than for Option 1, given that it involves imposing fewer training requirements.

**Impact on consumers**

58 Given current concerns in relation to the quality of advice that retail clients received prior to entering into margin loans, it is important to set appropriate minimum training standards for advisers. In ASIC's view, implementing Option 2 would involve a greater likelihood of retail clients not receiving advice from an adviser who is not sufficiently competent to provide that advice. Submissions to CP 108 were very supportive of the categorisation of margin lending facilities as Tier 1 products, and respondents' comments reflected these concerns.

59 This option would not impose any direct costs on consumers. However, depending on the costs incurred by each firm, some of these costs might

eventually be passed on to consumers in the form of increased fees (if the firm provides advice on a fee basis).

### Impact on government

- 60 To implement this option, ASIC would need to update and re-release RG 146, to include a new section on specialist knowledge for margin lending. ASIC has already received additional funding from Government to assist it to carry out policy work associated with the new regulation of margin lending and consumer credit, and would not apply for further funding in relation to this work.

### Impact table

- 61 Table 4 summarises the benefits and costs associated with this option, using the numerical scale set out in Table 5 to evaluate each individual impact.

**Table 4: Option 2—Impact analysis**

	Benefits	Costs
Consumers	Somewhat greater likelihood of receiving advice from advisers who are sufficiently competent and trained to provide that advice. (+1)	Costs of receiving advice may increase as industry passes on higher training costs. (-1)
Industry	<p><b>AFS licensees:</b></p> <p>Increased certainty from being provided with detailed minimum training standards for margin lending advisers, which will assist in the transition to regulation under Ch 7. (+ 1)</p> <p><b>Training course providers and industry and professional associations:</b></p> <p>Increased demand for training. (+2)</p>	<p><b>AFS licensees:</b></p> <p>Transitional and ongoing costs in completing the training requirements and maintaining competency. (- 2)</p> <p><b>Training course providers and industry and professional associations:</b></p> <p>Transitional costs in developing and providing courses. (- 1)</p>
Government	Reduced incidence of consumer complaints requiring ASIC assistance. (+ 1)	Transitional and ongoing costs of developing and enforcing new training standards for margin lending. (- 1)
Sub-rating	+ 5	-5
Overall rating		0

**Table 5: Rating scale for individual impacts**

+3	+2	+1	0	-1	-2	-3
Large benefit/ advantage compared to 'do nothing'	Moderate benefit/ advantage compared to 'do nothing'	Small benefit/ advantage compared to 'do nothing'	No substantial change from 'do nothing'	Small cost/ disadvantage compared to 'do nothing'	Moderate cost/ disadvantage compared to 'do nothing'	Large cost/ disadvantage compared to 'do nothing'

### Option 3: Status quo

#### Description of option

- 62 Under this option, ASIC would not make any amendments to RG 146 in relation to margin lending, nor would it make any public statement about its expectations in relation to training requirements for margin lending advisers. As described in paragraph 29, technically, if no amendment is made to RG 146, margin lending facilities will fall into the catch-all Tier 2 category; however, RG 146 wouldn't provide any further guidance relating to training requirements for margin lending facilities, as it does for other Tier 2 products. Instead, as part of its normal industry liaison and compliance work, ASIC would encourage industry to develop its own policies on training for margin lending advisers, to fill this gap.

#### Impacts

- 63 If only the generic requirements in Tier 2 apply, then individuals would have to determine for themselves what they would need to do. While this would give industry greater flexibility to decide what they thought was appropriate, it would also create greater uncertainty. The population of advisers in question is sufficiently diverse that they are not represented by one single industry body, which could logically take on the task of providing guidance to its members on training standards. A lack of guidance in this area could lead to a great deal of confusion, among advisers in particular. In addition, choosing this option would not reflect the strong current concern to improve the quality of advice provided to retail clients on margin lending. On balance, the greater uncertainty that would result would likely outweigh the benefits of greater flexibility, and the status quo is therefore a poorer choice relative to either of the other options.

## Consultation

- 64 ASIC released a consultation paper, Consultation Paper 108 *Margin lending: Training of financial advisers* (CP 108) on 13 July 2009. We received 11

responses to CP 108, from a variety of sources including three from training providers, and six from relevant industry and professional bodies.

- 65 Respondents were generally very supportive of proposals set out in the consultation paper. In particular, there was widespread support for ASIC's proposal to categorise margin lending facilities as Tier 1 products for the purposes of RG 146. Respondents were also generally supportive of the suggested new specialist knowledge training requirements for margin lending, which we set out in a draft updated version of RG 146 attached to the consultation paper. A few respondents suggested additional content for the specialist knowledge requirements, some of which we will include in the final updated version of RG 146.
- 66 Respondents did not express a great deal of opposition to ASIC's proposal to allow advisers 12 months from the commencement of the new legislation to complete the training requirements. However, many noted that the completion of all training requirements within our proposed transition period depends entirely on a number of key events occurring successfully, and requested ASIC take a flexible approach. This is discussed further below, in relation to our proposed approach to implementation.
- 67 Two responses were critical of the application of the training requirements to existing advisers. They both contended that it would be too onerous for existing advisers to undertake specialist knowledge training in margin lending, arguing that advisers should be able to meet their requirements some other way, for example, by attending an external seminar or completing a short course on margin lending. We do not agree with these views as:
- (a) RG 146 already has a great deal of flexibility built into it, to allow existing, experienced advisers to apply for recognition of their experience so that they do not have to complete the full knowledge and skill requirements;
  - (b) we do not think that allowing room to reduce the training standards any further is compatible with the Government's policy decision to regulate margin lending under Ch 7 of the Corporations Act, and general concerns about the quality of advice that has been provided to retail clients in relation to margin lending in the past; and
  - (c) we think that our proposed approach to transitional arrangements (discussed further below) will give advisers ample time to find and complete an appropriate RG 146-compliant course that specifically addresses specialist knowledge training for margin lending, without requiring them to cover material they have already previously studied.

## Conclusion and recommended option

- 68 We recommend Option 1. That is, we recommend updating and re-releasing RG 146 to include guidance on training requirements for margin lending, including categorising margin lending facilities as Tier 1 products, and including a new section on specialist knowledge for margin lending facilities, similar to those already included for other financial products.
- 69 We think that this option best meets ASIC's aims of protecting retail clients who seek and obtain financial product advice in relation to margin lending, helping advisers to understand how they can comply with their legal obligations in relation to competency and training, and helping training and education providers and professional and industry associations understand ASIC's regulatory requirements in relation to margin lending.
- 70 Option 1 is preferred to Option 2 because we think that Option 2 could ultimately be detrimental to consumers. ASIC has previously taken the view that products that are complex and/or market linked should attract the more onerous Tier 1 training requirements. Categorising financial products at the appropriate RG 146 level is essential to ensuring that ASIC's training policy fulfils its aims of assisting advisers to reach an appropriate level of competency, and protecting consumers of financial advice.
- 71 As discussed in paragraph 33, we think that margin lending facilities are complex and potentially associated with higher risks than other products. A margin lending facility encompasses both a credit element and an investment element, and advisers are likely to provide advice on both elements. Although a borrower's liability is limited to the amount borrowed, the actual value of the investment portfolio fluctuates on a day-to-day basis in accordance with market movements. Therefore, margin lending facilities share features of products generally categorised as Tier 1, and it is more appropriate that advisers who advise on margin lending facilities undertake the Tier 1 training requirements, including generic knowledge training about the economic environment as well as specialist knowledge of margin lending facility products at a more advanced Tier 1 level. In addition, in ASIC's view, the potential complexity of these products and the features and risks associated with them warrant the undertaking of training at the more advanced Tier 1 level.

## Implementation and review

- 72 Based on submissions to CP 108, and our discussions with relevant industry and training bodies, we propose to implement Option 1 with a transitional period, so that advisers will have until 18 months after the commencement of the new legislation to complete the training requirements. We think that this will allow sufficient time for training courses to be developed and registered

on the ASIC Training Register, and for advisers to complete training courses if necessary, while not unduly delaying full compliance with the training requirements. During this period, we will work with industry and with the relevant Industry Skills Council, Innovation and Business Skills Australia, and the organisation responsible for administering the ASIC Training Register, Learning Advisory Services Australia, to ensure a smooth transition.

## B Financial resource requirements

73 ASIC currently gives guidance on the financial requirements an AFS licensee will need to meet in RG 166 *Licensing: Financial requirements* (RG 166). This RIS addresses the options regarding what financial requirements ASIC should impose on an AFS licensee who deals in, or provides advice in relation to, a margin lending facility and the amendments to RG 166 and Pro Forma 209 *Australian financial services licence conditions* (PF 209) to reflect these requirements.

### Assessing the problem

74 Margin lending facilities have not previously been regulated as financial products under the Corporations Act. After the commencement of the new legislation, AFS licensees that deal in, or advise on, a margin lending facility (margin lending financial service), among other obligations, must:

- (a) have available adequate financial resources to provide the financial services covered by the AFS licence and to carry out supervisory arrangements (s912A(1)(d)); and
- (b) have adequate risk management systems (s912A(1)(h)).

75 The requirement in s912A(1)(d) to have adequate financial resources does not apply to a body regulated by the Australian Prudential Regulation Authority (APRA).

76 We estimate that there are currently around 10 margin lenders active in Australia. Of the margin lenders, six are regulated by APRA and therefore are exempt from the requirement to have adequate financial resources and carry out supervisory arrangements. We estimate that the balance of the population of margin lenders is made up of one lender who is a subsidiary of an APRA-regulated entity and therefore may be exempt from some of the base level requirements in Section B of RG 166 if it has a reasonable expectation of financial support from the parent entity that is an ADI. The remaining margin lenders will be subject to the financial resource requirements under RG 166. Of the three, one is an AFSL holder and therefore is already subject to the obligations under RG 166.

77 As part of ASIC's role as regulator of the financial services industry, we are responsible for setting the financial requirements that an AFS licensee must meet. These requirements are set out in Regulatory Guide 166: *Licensing: Financial requirements* (RG 166). However, the policy settings in RG 166 do not adequately address particular concerns associated with providing a financial service in relation to a margin lending facility.

## Current approach

- 78 Under our policy in RG 166, all AFS licensees must meet base level requirements, plus some licensees must meet additional specific requirements in certain circumstances depending on the type of financial products or services covered by their licence.
- 79 The base level requirements in Section B of RG 166 require that an AFS licensee must at all times:
- (a) be solvent;
  - (b) have assets that exceed liabilities as shown in the most recent annual balance sheet lodged with ASIC and have no reason to suspect that assets no longer exceed liabilities on a current balance sheet;
  - (c) meet cash flow requirements; and
  - (d) meet the audit requirements.
- 80 Under Section A of RG 166, all licensees not regulated by APRA must have risk management systems that specifically deal with the risk to financial resources. Further, the base level financial requirements in Section B of RG 166 apply to all AFS licensees except licensees regulated by APRA and market and clearing participants. Therefore, by virtue of a margin lending facility being characterised as a financial product under the Corporations Act, a licensee dealing in, or advising on, a margin lending facility will be required as a minimum, to comply with the requirements under Section A and B of RG 166.
- 81 When these requirements were introduced, they were justified on the basis that a licensee who provides a financial service in relation to a financial product will not be able to comply with their licence obligations unless they have sufficient financial resources to do so and are solvent. Requiring an audit of a licensee's compliance with these requirements is intended to enhance compliance by the licensee. We therefore think that imposing the financial requirements in Section A and Section B of RG 166 is necessary to help ensure compliance with key licensee obligations.
- 82 ASIC has not changed these base level requirements as a result of the regulation of margin lending facilities as financial products under the Corporations Act. This is because we see no basis to treat licensees who provide a margin lending financial service differently from other licensees in Section B of RG 166.
- 83 The specific financial requirements in Sections C-F of RG 166 apply to licensees depending on the type of financial products or services covered by their licence. Under Section E of RG 166, a licensee who deals or advises in relation to a margin lending facility and holds property on trust for a client or has the power to dispose of a client's property will be required to hold at

least \$50,000 in surplus liquid funds. We do not intend to vary the application of this requirement as it applies to margin lending activities. Otherwise, in the absence of regulatory action by ASIC, the remaining requirements in RG 166 would not apply to providers of margin lending facilities.

## Problems

- 84 The current financial resource requirements in RG 166 address the risk to consumers that an AFS licensee will have insufficient financial resources to comply with their licence obligations under Chapter 7 of the Corporations Act. Therefore, the risk to consumers is that the licensee will not comply with the licensing, conduct and disclosure requirements in Chapter 7. The key risk is that consumers are not aware of the extent to which margin lending facilities place the risk of changes to market conditions on them. The possibility of these consumers suffering unexpected consequences is particularly high in volatile market conditions. Further, a failure to notify a client of a margin call in a timely manner, for example, can result in significant losses, including resulting in the consumer going into negative equity.
- 85 The licensing, conduct and disclosure requirements in Chapter 7 address these risks to consumers. The financial resource requirements are intended to address the risk that the licensee's financial resources are not adequate to ensure the licensee is able to carry on its business in compliance with the obligations under Chapter 7.
- 86 The current policy in RG 166 in relation to specific financial requirements does have some problems. These problems are:
- (a) There is a risk to consumer protection and market integrity because the minimum requirements in Sections A and B of RG 166 do not adequately address particular concerns in relation to a margin lending facility.
  - (b) There is a potential confusion for industry in understanding how the existing financial requirements, which have been largely developed for products other than margin lending facilities, can be applied in relation to providers of margin lending facilities.

## Issues

- 87 Margin lending facilities have not previously been regulated as financial products under the Corporations Act. Accordingly, the policy settings in RG 166 do not address particular concerns associated with providing a financial service in relation to a margin lending facility. Therefore, it is necessary to consider amendments to RG 166 to address the following issues:

- (a) Issue 1 – Should ASIC impose additional financial requirements on a licensee who issues a margin lending facility?
- (b) Issue 2 – Should ASIC impose additional financial requirements on a licensee who issues a non-standard margin lending facility?
- (c) Issue 3 – Should the ASLF requirements in Section F of RG 166 apply if the lender has an undrawn credit balance?

## Objectives

- 88 The objectives of the financial resource requirements are to ensure that:
- (a) AFSL holders have sufficient financial resources to conduct their financial services business in compliance with the Corporations Act (including carrying out supervisory arrangements);
  - (b) there is a financial buffer that decreases the risk of a disorderly or non-compliant wind-up if the business fails; and
  - (c) there are incentives for owners of licensees to comply with licensees' regulatory obligations because of the risk of financial loss.

## Issue 1 – Should ASIC impose additional financial requirements on a licensee who deals in a margin lending facility?

- 89 Under Section C of RG 166, if a licensee is a responsible entity, an IDPS operator or is licensed to provide a custodial or depository service then net tangible asset (NTA) requirements apply. The NTA requirement in Section C of RG 166 will not apply to an issuer of a margin lending facility without amendment. An issuer of a margin lending facility should be required to demonstrate that it is an entity of financial substance by complying with the NTA requirements because dealing in a margin lending facility creates particular risks in relation to the management of client assets as well as risk in relation to transactional functions.

- 90 Possible options are:
- Option 1 (preferred option) – apply similar financial requirements as currently apply to other types of licensees under Section C of RG 166; and
  - Option 2 (status quo) - do not impose a \$5 million NTA requirement on a licensee who issues a margin lending facility.

## Options and impact analysis

### Option 1 (preferred option) – apply similar financial requirements as currently apply to other types of licensees under Section C of RG 166

#### Description of option

- 91 This option would require that a licensee who issues a margin lending facility must hold net tangible assets (NTA) of:
- (a) 0.5% of the value of the secured property or transferred securities, subject to a minimum requirement of \$50,000 and a maximum requirement of \$5 million; or
  - (b) at least \$5 million at any time that:
    - (i) it holds secured property or is the transferee of transferred securities under a margin lending facility; or
    - (ii) any other person holds secured property or is the transferee of transferred securities under the margin lending facility and that person does not have at least \$5 million NTA.
- 92 This option largely adopts the NTA requirements that are applied to the operator of an IDPS.
- 93 A number of businesses provide a margin lending service by re-branding as their own (white labelling) a margin lending facility provided by a lender. We do not intend to impose the NTA requirement on both the issuer/lender and the entity that arranges for the issue of the margin lending facility. We would only seek to impose the NTA requirement on the issuer/lender that is the mortgagee or holds the collateral under a margin lending facility.
- #### Impact on industry
- 94 As noted above, this option would affect only those margin lending providers who are not prudentially regulated by APRA. We estimate that there are four such lenders currently operating.
- 95 The cost to industry would arise from the opportunity cost of holding the required minimum level of net tangible assets (between \$50,000 and \$5 million, depending on the size of the provider). At an interest rate of 5.75% (representing the 10-year government bond rate), this option would involve a cost to licensees ranging from \$2,875 to \$287,500 per year. Margin lending is currently not regulated under the Corporations Act and therefore we do not have specific information regarding the value of property which secures the credit provided under margin lending facilities for specific businesses. Therefore, at this time we can only provide an estimated range to reflect the opportunity cost of imposing this financial resource requirement.

- 96 During consultation on CP 109, we did not receive any submissions suggesting the imposition of these requirements would cause any of the businesses to leave the industry. We did receive informal comment from one of the businesses that will be affected that they already comply with the financial resource obligations.
- 97 The licensee will either need to hold the NTA or appoint a professional custodian to hold secured property. As most if not all 'nominees' who hold client assets under a margin lending facility are not professional custodians changing custody arrangements will almost certainly involve additional up front and on-going costs to issuers.
- 98 However, licensees are able to count assets towards satisfaction of the financial requirements for different types of products. We expect that many issuers of margin lending facilities will also hold an AFS licence in relation to other products and may be required to comply with the NTA requirements. In that case, the net impact of ASIC imposing the NTA requirements on margin lending providers is therefore likely to be negligible.

#### **Impact on consumers**

- 99 Consumers will derive significant benefits from this option. Margin lending facilities create particular risks for consumers in relation to the management of the consumer's assets as well as risks in relation to transactional functions. The NTA requirement will promote the confidence of consumers by ensuring that an issuer of a margin lending facility is an entity of some financial substance and also ensure that the licensee has a buffer of assets so that inadequate financial resources do not place compliance with the licence obligations at risk.

#### **Impact on government**

- 100 This option would require ASIC to monitor compliance with the financial requirements. However, this would form part of ASIC's usual industry compliance efforts and would not impose any additional costs on ASIC. ASIC will be required to amend and re-issue RG 166.

#### **Other impacts**

- 101 It may be thought that there is a potential impact on competition, as ASIC will treat APRA-regulated and non APRA-regulated licensees differently. The *Corporations Act 2001* exempts APRA-regulated entities from the requirement to have available adequate financial services and therefore it is not a policy decision made by ASIC. However, although APRA-regulated licensees will not be subject to ASIC's financial requirements, they are subject to the capital requirements imposed by APRA.

102 APRA-regulated entities are required to maintain a minimum level of capital equal to 8% of risk weighted assets. APRA applies a risk weight for margin lending of 20% to outstanding loans that are backed by listed equities. Because ASIC is not a prudential regulator these requirements are much more onerous than the financial resource requirements imposed under RG 166. ASIC does not impose financial resource requirements to ensure that licensees are able to meet their financial commitments. ASIC imposes financial requirements to help ensure that a licensee has sufficient financial resources to conduct its financial services business in compliance with the *Corporations Act 2001* and there is a financial buffer that decreases the risk of a disorderly wind-up if the business fails. The financial resource obligations imposed by APRA and ASIC differ because of the different underlying principles for imposing the requirements

**Table 6: Option 1 – Impact analysis**

	Benefits	Costs
Consumers	There is a large benefit to consumers because there is a greater likelihood of compliance with the licence obligations. (+3)	No cost to consumers
Industry	Will benefit from increased market integrity because of the reduced risk of licensees not complying with the obligations under the Act and their licence. (+1)	There will be minimal industry impact because we estimate that only 4 issuers will be affected. Opportunity cost in holding net assets or increased costs in appointing a professional custodian. (-1)
Government	Reduced incidence of non-compliant behaviour requiring regulatory action by ASIC. (+1)	ASIC already monitors compliance with licence obligations and therefore minimal impact. Issuers will be required to vary their licence as a requirement under the new regime. (-1)
Sub-rating	+5	-2
Overall rating		+3

## Option 2: Do not apply Section C to margin lending

### Description of option

103 Under this option, ASIC would continue to apply the existing policy in RG 166. That is, because licensees who issue margin lending facilities are not specifically identified, the specific financial requirements would not apply to an issuer of a margin lending facility.

**Impact**

- 104 Under this option, there would be no additional cost to industry, however, a significant risk to market integrity and consumer protection due to the particular risks in relation to the management of client assets as well as risks in relation to the transactional functions performed by the issuer.

**Conclusion and recommended option**

- 105 We recommend Option 1. In particular, we recommend that ASIC impose NTA of between \$50,000 and \$5 million because, even if the licensee does not hold secured property, the licensee will still perform functions such as providing funds to settle client transactions, monitoring portfolios, reporting and providing notice of margin calls. This is analogous to an IDPS operator who may still perform a range of transactional functions even if they do not hold client assets. An IDPS operator is subject to the requirements under Section C of RG 166.
- 106 A client under a margin lending facility is placing substantial trust in the issuer/lender. The issuer should be required to demonstrate its financial substance. It is common for the terms of a margin lending facility to provide that the secured property may be transferred without the client's consent. For example, the terms of the facility may require that the client must give a power of attorney conferring authority on the issuer/lender, amongst other things, to sell the secured property without reference to the client.

**Issue 2 – Should ASIC impose additional financial requirements on a licensee who issues a non-standard margin lending facility?**

- 107 The adjusted surplus liquid fund (ASLF) requirement in Section F of RG 166 applies to a licensee if:
- (a) the licensee incurs actual or contingent monetary liabilities;
  - (b) this occurs by entering into a transaction with a client;
  - (c) the transaction is entered into in the ordinary course of providing a financial service to a client; and
  - (d) the aggregate liability to all clients exceeds \$100,000.
- 108 The sub-class of licensee that is primarily affected by this requirement include market makers, underwriters, some dealers and foreign exchange dealers who elect to comply with Section F.
- 109 The ASLF requirement will not apply to an issuer of a margin lending facility because the licensee does not incur a 'monetary liability' as a result

of entering into a transaction with a client. We believe, however, that the ASLF requirement should apply to an issuer of a non-standard margin lending facility,

110 A non-standard margin lending facility is a facility that includes a securities lending component, such as those used by entities such as Opes Prime and Tricom. The key difference for the client is that the title to the security provided for the loan is transferred to the dealer and this creates additional risk if the licensee does not maintain adequate financial resources.

111 Possible options are:

- (a) Option 1 (preferred option) – apply the existing ASLF requirements to issuers of non-standard margin loans; and
- (b) Option 2 (status quo).

## Options and impact analysis

### **Option 1 (preferred option) – apply the existing ASLF requirements to issuers of non-standard margin loans**

#### **Description of option**

112 Under this option, we will amend the circumstances under RG 166.105 in which the ASLF requirement will apply. This amendment will ensure that a licensee, who incurs a liability under the terms of a non-standard margin lending facility to retransfer marketable securities to a client, must maintain an ASLF equal to the sum of:

- (a) \$50,000; plus
- (b) 5% of adjusted liabilities between \$1 million and \$100 million; plus
- (c) 0.5% of adjusted liabilities for any amount of adjusted liabilities exceeding \$100 million.

113 A non-standard margin lending facility is a facility that includes a securities lending component. The key difference for the client is that title to the security provided for the loan is transferred to the issuer and this creates additional risk if the licensee does not maintain adequate financial resources.

114 Under a non-standard margin lending facility the client transfers the title to the marketable securities provided for the loan to another person. The marketable securities are not held on trust for the benefit of the client – instead the client merely has the right, in the circumstances determined under the terms of the facility, to be given equivalent marketable securities. This means that the licensee will need to use its own assets to meet the financial obligations to its clients and this implies that it will need to

carefully manage its assets and liabilities to enable it to meet its compliance obligations. By contrast, under a standard margin lending facility, the secured property is held on trust for the client and is separate from the licensee's assets and therefore does not raise the same concerns regarding the adequacy of its financial resources.

### Impact on industry

115 There is currently only one provider of non-standard margin lending facilities. The cost to industry is the opportunity cost of holding surplus liquid funds. However, to some extent the burden on industry is reduced because (subject to a minimum requirement of \$50,000) the requirement is scalable according to the size of the licensee. The minimum opportunity cost per annum based on a rate of 5.75% is \$2,875. If the licensee has adjusted liabilities of \$100 million then the opportunity cost per annum would equal \$5.75 million. As noted above, margin lending facilities are currently not regulated under the Corporations Act and therefore we do not have specific information regarding the value of property which secures the credit provided under margin lending facilities for specific businesses. Therefore, at this time we can only provide an estimated range to reflect the opportunity cost of imposing this financial resource requirement.

116 Industry will benefit from the introduction of the ASLF requirement because of improvements in market integrity and the reduced likelihood of non-compliant competitors in the industry.

### Impact on consumers

117 As with issue 1 discussed above, consumers will derive significant benefits from this option. There is a risk that, in the absence of financial adequacy requirements on issuers of non-standard margin lending facilities who hold client securities, the issuer may default on their obligations to their client.

### Impact on government

118 This option would require ASIC to monitor compliance with the financial requirements. However, this would form part of ASIC's usual industry compliance efforts and would not impose any additional costs on ASIC. ASIC will also need to update and re-issue RG 166.

**Table 7: Option 1 – Impact analysis**

	Benefits	Costs
Consumers	There is a large benefit to consumers because there is a greater likelihood of compliance with the licence obligations. (+3)	No cost to consumers

	Benefits	Costs
Industry	Will benefit from increased market integrity because of the reduced number of non-compliant participants. (+1)	There will be minimal industry impact because we estimate that only 1 issuer will be affected. Opportunity cost in holding surplus liquid funds. (-1)
Government	Reduced incidence of non-compliant behaviour requiring regulatory action by ASIC. (+1)	ASIC already monitors compliance with licence obligations and therefore minimal impact. Issuers will be required to vary their licence as a requirement under the new regime. (-1)
Sub-rating	+5	-2
Overall rating		+3

## Option 2 (status quo): Do not impose the ASLF requirement on an issuer of a non-standard margin lending facility

### Description of option

- 119 The ASLF requirement will not apply to an issuer of a non-standard margin lending facility without the recommended amendment.

### Impacts

- 120 It is arguable that in light of the NTA requirements imposed on an issuer of a non-standard margin lending facility it is unnecessary and an unreasonable burden to impose an additional ASLF requirement.
- 121 We believe that this approach does not adequately reflect the additional risk to the financial resources of a licensee inherent in the securities lending component of a non-standard margin lending facility. Imposing the ASLF requirement reflects this additional risk.

## Conclusion and recommended option

- 122 We recommend Option 1. The ASLF requirement is appropriate to reflect the additional risks for managing financial resources inherent in a non-standard margin lending facility because it is a way of providing a more comprehensive measure of the availability of liquid assets to the licensee in light of the scale of its operations and various risks to the licensee's financial resources in the current period. The ASLF requirement also provides a trigger to identify AFS licensees at risk of non-compliance.

### Issue 3 - Should the ASLF requirements in Section F of RG 166 apply if the lender has an undrawn credit balance?

- 123 A licensee who deals in a margin lending facility may have to comply with the ASLF requirement in Section F of RG 166. This may occur, for example, when a lender agrees to provide credit to another person under a margin lending facility but the credit remains undrawn or it is drawn down in tranches and the aggregate liability to all clients exceeds \$100,000.
- 124 Possible options are:
- (a) Option 1 (preferred option) – exempt the ASLF requirements if the lender has an undrawn credit balance;
  - (b) Option 2 (status quo) – continue to apply the existing ASLF requirements in RG 166.

## Options and impact analysis

### Option 1 (recommended): exempt the ASLF requirements if the lender has an undrawn credit balance

#### Description of option

- 125 Under this option we would amend Section F of RG 166 so that a lender will not have to comply with the ASLF requirement in RG 166 if the lender agrees to provide credit under a margin lending facility and the credit remains undrawn or it is drawn down in tranches.

#### Impacts

- 126 This option reduces the regulatory burden that would otherwise be imposed on issuers of margin lending facilities.
- 127 Imposing the ASLF requirement because a lender has clients with undrawn credit balances may encourage lenders to ensure that their clients are drawn down to their maximum capacity.
- 128 Imposing the ASLF requirement may therefore encourage clients to be fully geared, which creates greater risks for the client and is inconsistent with consumer protection messages that discourage maximum levels of gearing. Section F of RG 166 should be amended to avoid this unintended consequence of imposing the ASLF requirement so that a liability consisting of an undrawn credit balance will be disregarded for the purposes of determining whether the lender must comply with the ASLF requirement.

**Table 8: Option 1 – Impact analysis**

	Benefits	Costs
Consumers	Negligible impact on consumers	Negligible impact on consumers
Industry	Benefits for industry, as they would not need to comply with the ASLF requirements where no service has been performed for clients (eg if credit has not yet been drawn down) (+1)	No additional costs for industry.
Government	Negligible impact on government.	Negligible impact on government.
Sub-rating	+1	0
Overall rating		+1

### Option 2: Status quo

- 129 Under the status quo, a licensee who deals in a margin lending facility may have to comply with the ASLF requirement in Section F of RG 166. This may occur, for example, when a lender agrees to provide credit to another person under a margin lending facility but the credit remains undrawn or it is drawn down in tranches and the aggregate liability to all clients exceeds \$100,000.

## Conclusion and recommended option

- 130 We recommend Option 1. Complying with the ASLF requirements would pose an undue burden on licensees and may have the unintended consequence of encouraging consumers to be fully geared.

## Consultation

- 131 On 13 July 2009, ASIC issued Consultation Paper 109 *Margin lending: Financial requirements* (CP 109) seeking comment on our proposals on the financial resource requirements we will impose on a licensee who provides a financial service in relation to a margin lending facility.

- 132 The Respondents were largely supportive of our proposals in CP 109. We received four responses to CP 109 from relevant industry bodies and a law firm. The submissions were either unqualified in their support, qualified in some respect or sought clarification on the application of a particular proposal.

133 Most respondents only provided feedback on a small number of key issues of particular concern to them. In particular the respondents did not object to any of the financial resource requirements considered in this RIS.

134 The main issues raised by respondents related to:

- (a) whether ASIC should exempt a subsidiary or a related body corporate of an authorised deposit-taking institution (ADI) from the financial resource requirements in RG 166; and
- (b) whether ASIC should impose more prescriptive compliance obligations in RG 166.

### **Should subsidiaries of ADIs be excluded?**

135 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**

136 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.

137 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 we impose more prescriptive compliance obligations?**

138 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).

139 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**

- 140 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.
- 141 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.
- 142 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.

## **Implementation and review**

- 143 As the proposed changes in relation to issuers of margin lending facilities basically mirror the existing requirements for other AFS licensees under RG 166, there will be little adjustment required to ASIC's systems and processes or to the type and format of information required to be submitted to ASIC by regulated entities.