

Corporate Alert

February 2010

Margin Lending - Issuers and Advisers must be licensed

The *Corporations Legislation Amendment (Financial Services Modernisation) Act* ('Act') (which commenced on 1 January 2010) now classifies a 'margin lending facility' as a financial product. As a result, issuers of margin lending facilities and intermediaries who provide advice on margin lending facilities (such as financial advisers) have until 30 June 2010 to apply for an AFS licence or a variation to an existing AFS licence to comply with the new licensing requirements.

The Act imposes the following regulatory timetable for margin lending issuers and intermediaries:

Commencement of the Act	1 January 2010
Application period for AFS licence or a variation to an existing AFS licence	1 February 2010 to 30 June 2010
Closing Date for licence or variation application	30 June 2010
Commencement of new conduct and disclosure requirements	1 January 2011
Deadline for compliance with training standards under RG 146	1 July 2011

Changes you will need to consider

AFSL licence must have specific authorisation

An AFSL licence must contain specific authorisation to issue, deal or provide financial product advice in relation to a margin lending facility.

Disclosure requirements

In addition to the usual product disclosure requirements that apply to all financial product licensees, margin lenders must comply with additional prescribed content requirements which must be included in a margin loan PDS. It is anticipated that the Regulations containing these prescribed content requirements will come into effect in the latter part of 2010.

Some of the key requirements prescribed for a margin loan PDS in the draft Regulations include:-

- a short explanation of margin lending and how a margin loan operates - including explanations of the maximum loan amount and LVR ratios. These explanations must be illustrated with examples;
- 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 and that other assets provided as security

for the loan (such as residential property) may have to be sold to repay the loan in such circumstances;

- specific disclosure requirements in relation to margin calls and how a call operates - including disclosure of the specific level beyond which a margin call is triggered. This section of the PDS must also contain a description of the risks associated with the margin loan facility such as the risk that:-
 - » the value of the client's investments might fall and the possible consequences of that drop in value;
 - » lenders may change the LVR of any given investment and the possible consequences;
 - » the lender may remove any given investment from their Approved Product List and the possible consequences;
 - » the interest rate may rise and the consequences of that rise - in particular, the possibility that interest payments may exceed the returns available from the investment portfolio; and
 - » tax laws may change and possibly have a negative impact on the borrower's tax position.

Notably, the pro forma margin loan PDS may be tailored to suit the specific financial products so long as it meets the minimum content requirements prescribed by the Regulations and is no longer than four A4 pages of content (with additional pages containing a title and table of contents).

Responsible lending guidelines

New responsible lending requirements will apply where a margin lending facility is issued to a retail client. An issuer of a margin lending facility must now:-

- make an assessment as to whether the facility will be suitable for the investor before issuing or increasing the limit of a margin lending facility;
- make reasonable inquiries about the retail client's financial situation;
- take reasonable steps to verify that information; and
- make certain inquiries including, for example, whether the client has taken out a loan to fund the equity contribution (double gearing) and, if so, whether the security for the loan includes residential property. There is no requirement to make assumptions about potential future developments.

If after making such inquiries, a margin loan facility is assessed as unsuitable, it must not be provided to the client. Failure to comply with this requirement is an offence and may lead to a maximum fine of \$200,000 (for an individual) or \$1,000,000 (for a body corporate) or imprisonment or both.

In addition, limits will be imposed on the amount which can be advanced to a retail client under a margin loan based on the client's serviceability – that is, assessing whether a retail client can comply with his/her financial obligations under the terms of the margin loan facility in the event of margin call or where compliance will cause 'substantial hardship'.

Lender to notify retail clients of a margin call

A margin lender is primarily responsible for notifying a retail client of a margin call. This rule will not apply only if there is an express agreement between the margin lender and the retail client that another AFSL holder (such as their financial adviser) is authorised by the retail client to receive notification of the margin call.

Immediate action for Margin Lenders and Intermediaries to Consider

- Ensure that your AFSL licence has specific authorisation for margin lending activity;

- Ensure your disclosure documentation complies with the new pro forma PDS requirements;
- Ensure your advisory staff are appropriately qualified and trained to assess a retail client's suitability for a margin loan and that they understand consumer risks, how a margin loan operates and the methodology of LVR;
- Ensure your margin lending sales team understands the disclosure requirements of the Act when making representations to a potential client about the margin lending facility; and
- Ensure your margin call notification process addresses the new legal regime.

For further information on margin lending, financial services or the new consumer credit requirements please contact:



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