

DRAFT EXPLANATORY STATEMENT

Select Legislative Instrument 2009 No.

Issued by the Authority of the Minister for Human Services, Financial Services,
Superannuation and Corporate Law

Corporations Act 2001

Corporations Amendment Regulations 2009 (No.)

The *Corporations Act 2001* (the Act) makes provision in relation to corporations and financial products and services.

Section 1364 of the Act provides that the Governor-General may make regulations prescribing matters required or permitted by that Act to be prescribed, or necessary or convenient to be prescribed for carrying out or giving effect to that Act.

The Act has been amended by the *Corporations Legislation Amendment (Financial Services Modernisation) Act 2009* for the purpose of regulating certain financial products, including margin lending facilities. A margin lending facility is defined in new section 761GA of the Act, and relates principally to the provision of credit wholly or partly to acquire one or more financial products (which is also defined in the Act). Margin loan borrowers currently do not benefit from any protection measures specifically tailored to their requirements.

The amendments to the Act in relation to margin lending facilities prescribe that lenders must observe responsible lending requirements intended to ensure that consumers are not given loans they cannot afford to service. Clarification is also provided concerning who is responsible for notifying the client when a margin call is made. Transitional arrangements are provided which principally set out the timelines and interim regulatory arrangements that apply for licensing margin loan providers and advisers.

The Act refers to 2 aspects of a margin lending facility: the facility itself and the variation of a facility to increase the limit of the facility. This Explanatory Statement will refer to a “margin lending facility” to describe both of those aspects.

Margin lending facilities have been specified in the Act as financial products, to which the provisions of the Act now apply. The Act authorizes the making of regulations relating to specific financial products, supplementing the coverage of the Act and allowing arrangements to be made that meet the specific requirements of the products.

The purpose of these Regulations is to make arrangements for margin lending facilities complementing the amendments to the Act. The main provisions introduced by these Regulations are the following:

- The unsuitability assessment provided as part of the responsible lending requirements does not constitute the provision of financial advice.

- A detailed methodology is provided for calculating the monetary threshold contained in the Act for distinguishing between retail and wholesale clients in relation to margin loans.
- Specific arrangements are prescribed for situations where a credit limit breach occurs due to unilateral action by the borrower that is beyond the control of the provider. The arrangements allow a grace period for conducting the unsuitability assessment within a defined period after the breach occurs.
- A number of specific matters are prescribed that lenders must take into account when conducting the unsuitability assessment as part of the responsible lending requirements. These are matters that are considered to contain particular risks to potential borrowers. It is further prescribed that the same matters must be addressed in a Statement of Advice that recommends a margin loan.
- A number of situations are specified for which margin loan must be assessed to be unsuitable for the client.
- There are situations where a margin lending facility may turn out to be unsuitable, in spite of the best efforts of the provider in conducting the unsuitability assessment. A provision is made stating that in such cases no breach of the law is taken to have occurred on the part of the margin loan provider.
- The contents of periodic statements for margin lending facilities are defined.

Details of the Regulations appear in the Attachment.

The Act does not specify any conditions that need to be satisfied before the power to make the Regulations may be exercised.

The Regulations are a legislative instrument for the purposes of the *Legislative Instruments Act 2003*.

The Regulations will commence on **TBA**.

ATTACHMENT

DETAILS OF THE CORPORATIONS AMENDMENT REGULATIONS 2009 (No.)**Part 1 Preliminary**Regulation 1 – Name of Regulations

Regulation 1 provides that the name of the Regulations is the *Corporations Amendment Regulations 2009 (No.)*.

Regulation 2 – Commencement

Regulation 2 provides that the Regulations commence on **TBA**.

Regulation 3 – Amendment of *Corporations Regulations 2001*

Regulation 3 provides that the *Corporations Regulations 2001* (Corporations Regulations) are amended as provided for in Schedule 1 to the Regulations.

Schedule 1 – AmendmentsAmendment [1]

Section 766B of the Act explains the meaning of the expression ***financial product advice***. The section identifies a number of activities that are taken not to be the provision of financial product advice, including the provision or giving of an exempt document or statement.

The definition of ***exempt document or statement*** in subsection 766B (9) of the Act allows regulations to be made prescribing documents or statements.

Responsible lending requirements will be imposed on margin loan lenders, requiring them to make a written assessment of a potential client's ability to afford and service a margin loan without experiencing undue hardship. This is the assessment of unsuitability required in subsection 985E (1) of the Act. It is possible that this activity could be regarded as the provision of financial product advice, which attracts a range of regulatory requirements such as the provision of a Statement of Advice. This is considered to impose an unnecessary compliance burden on businesses.

Regulation 7.1.08 prescribes the unsuitability assessment with the effect of ensuring that a lender does not provide financial product advice when making an unsuitability assessment.

Amendment [2]

Section 761G of the Act explains the difference between a retail client and a wholesale client to whom a financial product or a financial service is provided. Substantial relief from the requirements in the Act is provided where a financial product or service is provided to a wholesale client. A number of tests are prescribed for making the distinction.

Paragraph 761G (7) (a) of the Act provides that if a financial product is not, or a financial service provided to a person does not relate to, a general insurance product, a superannuation product or an RSA product, the financial product or financial service is provided to the person as a retail client unless the price for the provision of the financial product, or the value of the financial product to which the financial service relates, equals or exceeds the amount specified in regulations made for the purposes of that paragraph as being applicable in the circumstances. The amount is specified to be \$500,000 in the Corporations Regulations.

In some instances it may not be immediately apparent how the price of a particular product or service is calculated, and the Act provides the necessary powers to prescribe particular calculation methodologies by regulation.

Regulation 7.1.19A explains how to work out the price for the provision of a margin lending facility, or an increase in a margin lending facility. In the case of the provision of a margin loan, the price is to be calculated based on the value of the equity provided by the client. In the case where an existing margin loan limit is increased, the price is to be calculated by adding the value of the additional equity provided to any equity provided in the past. This approach is considered to most closely reflect the policy intention with respect to the calculation used for investment products and services, where the amount invested by the client is generally equity held by the client.

Amendments [3] and [4]

Existing regulation 7.1.34 specifies two types of situations in relation to credit that do not constitute "dealing". The first is in relation to the enforcement of rights under a credit facility and the second is in relation to the disposal of a financial product that is subject to a mortgage or the transfer of the financial product to the mortgagor. It would appear that both situations fall within conduct that a margin lender would ordinarily engage in. For example, a margin lender that makes a margin call on a client would arguably be enforcing rights under a credit facility while a margin lender that sells a financial product where a margin call is not met would arguably dispose of a financial product that is subject to a mortgage. There appears no policy basis why these situations should be excluded from dealing conduct for margin lending facilities.

Accordingly, provisions are made ensuring that conduct in relation to margin lending facilities is not afforded the benefit of this exclusion.

Amendment [5]

The Act provides that, whenever a licensee gives a retail client personal financial advice, the client must be given a Statement of Advice (SOA) containing the advice as well as a range of other prescribed information.

Subsection 947B (2) of the Act sets out the required content of an SOA. Paragraph 947B (2) (g) provides that the SOA must include any other statements or information required by the regulations.

Regulation 7.7.09AA says that where a licensee provides advice to a retail client concerning margin loans, information in relation to the special matters prescribed by subsection 985F(1)(c) must be included in the SOA. These are matters that are considered to contain particular risks to margin loan borrowers, and which should

therefore be carefully considered by lenders and advisors before providing or recommending a margin loan. Further detail on these matters is provided below in the discussion under Amendment [7].

Amendment [6]

This amendment contains the same requirements as Amendment [6] where advice in relation to a margin loan is provided by an authorized representative of a financial services licensee (and not by the licensee itself).

Amendment [7]

Regulation 7.8.08A

This amendment addresses the situation where a margin loan borrower, without informing the lender in advance, purchases shares or other financial products and gives instructions to settle the trade through the margin lending facility such that a breach of the credit limit would result if the trade was to go through by borrowing additional funds from the margin lending facility. Rather than failing the trade on the basis that no assessment of unsuitability had been done for the credit limit increase, it has been suggested that a mechanism should be introduced allowing the margin lender to settle the trade but subject to the requirement to conduct the unsuitability assessment within a certain period of time.

Regulation 7.8.08A achieves this by providing that where a credit limit increase occurs through a unilateral contribution of additional security by the borrower without the prior knowledge or agreement of the lender, and where the increase is no more than 5% of the credit limit, the unsuitability assessment may be conducted up to 90 days after the limit increase occurs.

It is noted that if the unsuitability assessment concludes that the limit increase is unsuitable, then the lender will have to take steps to reduce the outstanding loan amount back to within the previous credit limit.

Regulation 7.8.09

Subsection 985F(1)(c) of the Act says that certain matters may be prescribed by the regulations to be taken into account when making an assessment of unsuitability as required in section 985E.

Regulation 7.8.09 identifies a number of matters that must be taken into account when conducting the unsuitability assessment. These are matters that are considered to constitute key risks for the borrower and which may lead to harmful consequences if they are not properly understood and managed in the course of providing the margin lending facility.

Experience shows that problems can occur where clients have taken out a second loan to finance their equity contribution for the margin loan, in particular where they have used their homes to secure this second loan. This creates a scenario known as 'double gearing' which may in some situations lead to the risk of clients losing their homes, if they are unable to service their loans following a margin call. The regulation

therefore prescribes 'double gearing' situations as a matter that must be considered by lenders in assessing the possible unsuitability of the proposed loan for the client.

Other prescribed matters that must be considered include the amount of other debt incurred by the client, as well as the provision of a guarantee by a third party, and in particular whether that third party has been appropriately warned about the risks to which it is being exposed. The regulation also allows ASIC to prescribe other matters which must be taken into consideration for the unsuitability assessment.

Regulation 7.8.10

Subsection 985H (2) (b) of the Act provides that the regulations may prescribe particular situations in which the issuer of a margin lending facility must assess a margin loan as unsuitable for the client.

Regulation 7.8.10 prescribes two such situations. A loan must be assessed as unsuitable where the client is unable to be contacted and has not appointed an agent, as this would mean that margin calls may not be able to be notified to the client, or where the client is legally incapable of entering into an agreement, for example because of bankruptcy.

7.8.10A

There are situations where a margin lending facility may turn out to be unsuitable, in spite of the best efforts of the provider in conducting the unsuitability assessment. In such a situation it would be unreasonable to penalize the lender on the grounds of having provided an unsuitable margin lending facility.

Regulation 7.8.10A A provision is made stating that in such cases no breach of the law is taken to have occurred on the part of the margin loan provider, provided the original unsuitably assessment was conducted in accordance with the relevant provisions in the Act.

Amendment [8]

Section 1017D of the Act provides that periodic statements must be provided to holders of certain financial products, and sets out minimum information that must be included in a statement. Subsection 1017D (5) of the Act sets out the content of a periodic statement, while paragraph 1017D (5) (g) provides that a statement must also include details prescribed by the regulations.

Regulations 7.9.30A and 7.9.30B are contained in a new Subdivision 5.4A of Division 5 of Part 7.9 of Chapter 7 of the Act.

Regulation 7.9.30A applies the Subdivision to a margin lending facility.

Regulation 7.9.30B prescribes information particular to margin lending facilities, to largely replace the information in subsection 1017D (5) (which was designed for investment rather than credit products). The prescribed information includes key matters such as the outstanding loan amount, the current interest rate, an itemized list of the security provided for the loan together with the valuation applied to each item,

the loan to security ratios, as these determine when a margin call may be issued, and a summary of all transactions that occurred during the reporting period.