

SENATE STANDING COMMITTEE ON ECONOMICS QUESTION
(Supplementary Budget Estimates 20 October – 21 October)

Question: SBT 197

Topic: Supervision of margin lending

Senator Pratt asked:

Mr D'Aloisio—We think, for margin loans for the retail investor-financial consumer, the degree of take-up, the knowledge of those products now and the disclosure that is required when you use it with a retail investor will add quite a good degree of protection for the investors. The consumer finance credit legislation again adds another level of protection in relation to consumer loans and so on. So at the moment we are not seeing it as an area that is going to explode and be a problem. I think there are things that are working their way through, and the indications are that people understand the pitfalls of margin lending more clearly today than they did in the last market movement upwards.

Senator PRATT—So, when the market does next move upwards, the provisions in the new act that require things like advisers providing advice that is appropriate to a client's circumstances will all be in place; is that correct?

Mr D'Aloisio—In so far as responsible lending and it coming in for financial consumers, we have got that guide; that is Reg. Guide 209. We are in the process of issuing another guide in relation to the disclosure of margin loan products over the next few weeks. Again, that will complement that further disclosure around the margin lending products.

Senator PRATT—And are the dispute resolution services in place now as well?

Mr D'Aloisio—Yes, I believe so. Where you are a financial services licensee, you have to have alternative dispute resolution methods, both internal and external, and those would be in place.

Senator Sherry—I will just mention that, from a policy point of view, the government identified the regulation, supervision and oversight of what is known broadly as consumer credit, which included margin lending. That is—or was—done by state governments, because it was a state supervised area. Some three years ago, we took a policy decision to seek to have the states transfer those responsibilities to the Commonwealth, and I will not go into the detail. Obviously the transfer has only just occurred and there are a range of supervisory guidance notes and consumer protections. Until that time, there was little if any supervision of margin lending in Australia. That is not a criticism of the states. I just think that the sector has grown dramatically, although it has significantly contracted as a consequence of the GFC. But certainly, up until the GFC, margin lending had grown very significantly in terms of the individuals engaging in that activity. It is not a criticism of the states, but I do not think they were particularly well equipped to supervise this area of significantly growing financial activity. So, for a number of reasons, we took a policy decision to transfer regulatory and supervisory responsibility. Mr D'Aloisio and I have indicated this. I will take it on notice. I am sure we can get you some figures on the level of margin lending either through ASIC or through the department.

Mr D'Aloisio—Yes, we can.

Answer:

1. *What is the progress on licensing those involved in margin lending?*

As at April 2011, 977 applications to issue and advise in margin lending facilities have been lodged with ASIC and 856 have been approved. The remaining applications are being assessed. Of the applications that have been approved so far, approximately 24 are margin lender, with the remainder being advisers.

2. *What is the extent to which people involved in taking out margin loans are now less vulnerable to loss?*

Firstly, issuers, dealers and advisers of margin lending facilities will now be subject to the licensing regime under the Corporations Act.

Senate Standing Committee on Economics

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From 1 January 2011, issuers and advisers must have an Australian Financial Services Licence (AFSL) (or be an authorised representative of an AFSL holder) to issue and advise on margin lending facilities. They will be subject to the conduct and disclosure requirements of the licensing regime including the statutory obligation to operate efficiently, honestly and fairly and to manage conflicts of interest. A licensee must also maintain the competence to provide the financial services authorized on the licence and maintain adequate professional indemnity insurance. Consumers will have access to external dispute resolution services from 1 January 2011. The training standards required by ASIC for retail client advisers must be met by margin loan advisers from 1 July 2011.

Secondly, effective from 1 January 2011, the legislation imposes new responsible lending requirements on the issuers of margin lending facilities and clarifies the responsibility for providing notification of margin calls. Lenders are required, before issuing a loan or increasing the limit on an existing loan, to make an assessment whether the loan facility is "unsuitable" for that retail client. There is guidance in the legislation as to when a loan may be considered unsuitable and there is a requirement to make reasonable inquiries about the retail client's financial situation and to verify that information. The legislation also allows lenders to rely on information provided in a Statement of Advice (SOA) and not to have to verify it, provided it was prepared no more than 90 days before the entering into of the facility (or an increase in limit). The SOA prepared by the adviser must contain the reasonable enquiries about the client's financial situation.

Thirdly, ASIC has issued a regulatory guide for margin lender providers on the disclosure (in the Product Disclosure Statement (PDS)) that we expect to see in relation to non standard margin lending facilities. In providing the guide we seek to improve the disclosure given to investors to ensure they may make an informed investment decision. The Regulatory Guide was released on 10 November 2010. It is RG 219 *Non-standard margin lending facilities: Disclosure to investors*. Effective from 1 January 2011, the content obligations of a short PDS for a standard margin lending facility is prescribed in detail by the Corporations Regulations, including specifications as to length (must not exceed 4 A4 pages), the clear layout and content of sections and a summary of significant information about the product.

Fourthly, ASIC sets out extensive user friendly plain English information on margin loans on the Moneysmart website. This includes a discussion of the risks, questions to ask of an adviser, information on margin calls and easy to follow worked examples on meeting a margin call.

3. *What are the current levels of margin lending and how do those compare with previous periods? (Eg before and after the global financial crisis).*

The latest available figures show that a total of \$18.8 billion of margin loans were outstanding as at 30 June 2010. This figure is little changed from June 2005, when it was \$17.9 billion. From a level of less than \$7 billion in 2000, the level of margin loans climbed steadily to peak at \$37.8 billion in December 2007, before quickly halving to \$18.7 billion in March 2009 (reference - Table D10 – Margin Lending of the Reserve Bank of Australia's statistical tables. Available online at: <http://www.rba.gov.au/statistics/tables/index.html>).

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