ASA Submission: Green Paper on Financial Services and Credit Reform

This submission is the ASA's response to the Australian Government's Green Paper on Financial Services and Credit Reform (Green Paper). This submission addresses those issues outlined in the Green Paper which are relevant to retail shareholders. These are trustee corporations, margin loans and debentures.

The ASA

The Australian Shareholders' Association (ASA) is a not-for-profit organisation formed to represent, protect and promote the interests of investors in shares, managed investments, superannuation and other financial investments.

Submission

Trustee Corporations

The ASA supports the reform of trustee corporations regulation to reflect the current status of these corporations as well as the increasingly centralised nature of financial services and business in Australia.

There are however issues which arise as a result of the recommendations of the Green Paper and in particular the recommendation made that the legislation be implemented and regulated by ASIC.

The ASA is concerned about what appears a trend to fold more and more responsibilities into ASIC. The recent budget brought the Financial Literacy Foundation into ASIC (without any increase in funding) and there is the possibility that ASIC may be called on to take over the role currently carried out by ASX Market Supervision.

The ASA is concerned that this activity is effectively building a super-regulator with little consideration as to whether the culture, systems or indeed funding of ASIC can ever be geared to properly manage such diverse responsibility.

An indirect concern which arises is in relation to the use of reference to trustee corporations in marketing and communications. In the ASA experience there are frequently statements made in marketing material of managed investment schemes (MIS) as to the role of the Trustee when acting as custodian, which are not understood by retail investors. These statements lead investors to believe that there is some protection offered by the trustee to the unit holders, when this not the role of the trustee acting as custodian for the responsible entity.

Whilst there is no research available at this time, a brief survey of internet forums populated by unit holders of failing managed investment schemes show that retail investors believed (despite what the PDS may have said) that the Trustee offered a guarantee that they would be able to redeem funds.[1]

Margin Loans

The ASA does not agree that investors who raise funds by way of margin lending are primarily sophisticated investors. The ASA's experience is that many of these retail investors, even those at the more sophisticated end of the spectrum, lack an understanding of the downside risks of margin lending.

For this reason the ASA does not support Option 1 suggested in the Green Paper, which would see the status quo unchanged.

Whilst the folding these loans into financial products and regulating on the basis of the existing Chapter 7 of the Corporations Act 2001 is tempting as a low intervention strategy, the hybrid nature of the loan, part investment advice, part credit means that it should be subject to specific tailored rules.

There are a number of areas where specific regulation of margin lending should be considered. These are:

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[1] The ASA viewed the Austock forum on Octaviar Premium Income Fund (a MIS which has frozen redemptions)

1. Notice of margin calls provided to clients. As indicated in the Green Paper, there are instances where the contract governing the loan does not require notice of a call to be provided to the borrower. Clearly this provides the borrower with no opportunity to provide further collateral or consider refinancing;
2. Where notice of a call is provided the time frame given to restore rectify. Specific investor complaints to the ASA include complaints that lenders did not allow any time to complete a re-financing arrangement before selling the securities;

The Paper touches briefly on the related issue of margins loans entered into by directors to purchase company stock. The ASA position is that such loans should be considered as part of the risk management of any company. As all listed companies should have a policy which:

1. Requires directors to report any margin borrowing in relation to company stock to the board;
2. Requires the board to consider whether any borrowing should be disclosed under the market operators continuous disclosure rules;
3. Considers the impact of such lending from a risk management perspective.

Debentures

Although offers of debentures are not directly within the ASA's remit, many ASA members and other retail shareholders having been caught up in the failures of Westpoint and Fincorp, have looked to the ASA to provide support and information.

The ASA through its membership of the ASIC CAP has been involved ASIC community consultation with regard to unlisted, unrated debentures.

The ASA believe that the suggested approach of harmonising the regulation of promissory notes is a positive step. The important issues are:

1. Potential investors need to be provided with clear and easily understood information about the high risk nature of debentures. The ASA believe that this is best provided through a product disclosure document treatment of all debentures offers;
2. Those offering debentures need to be approved and have appropriate resources, levels of capital liquidity, risk management and compliance structures. The way to ensure this is to require that all issuers of debentures are licensed.

The ASA experience is that the unsophisticated retail investors, who are overwhelmingly the target market for these offers, have a limited understanding both of the operation and the risks of the investment. The approach suggested in the Green Paper will go some way towards improving the information provided to potential investors. However improving the underlying problem - the level of financial literacy in the community - is vital. The ASA are therefore concerned that the Financial Literacy Foundation has been folded into ASIC. Without a discrete budget and previous levels of staffing it is unlikely that the Foundation can continue the good work it has only just begun.