

Weigh up the options

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There may be less margin lenders to choose from but each one presents a slightly different offer. Planners can use these key considerations to compare providers.

Advisers are not so spoiled for choice of margin lender as they once were. Over the past few years, several players have merged or dropped out of the market but still there are at least 10 major lenders to pick from.

Each lender presents a slightly different offer. Financial planners have to decide which provider presents the features and services that best meet their needs and those of their clients.

On the whole, advisers are reasonably happy with the options available to them. According to Investment Trends' research, 56 per cent of planners said their main lender was either good or very good. That rate is consistent with research findings in previous years.

However, advisers are less satisfied with their secondary lender than they have been in the past. Only three in 10 gave their second choice a good or very good rating, down from one third of planners in earlier surveys, Investment Trends' research found.

Cost was the main factor that affected advisers' selection of one lender over another. The research showed that 77 per cent of those who responded nominated that the interest rate charged was the primary consideration.

The average margin lending interest rate was 9.65 per cent at the end of February 2011, the Reserve Bank of Australia's data shows. That's 1.85 percentage points higher than the average standard variable home loan offered by banks, at 7.8 per cent.

Canstar Cannex financial analyst Mitchell Watson says margin lending rates are higher because lenders attach higher levels of risk to shares and managed funds which are more volatile than residential property.

Suncorp Bank offers the lowest variable interest rates on margin loans, charging 9.24 per cent on a \$50,000 loan and 8.99 per cent on loans worth more than \$500,000, according to Canstar Cannex (see table, page 19).

Higher up the interest rate scale, ANZ charges 9.79 per cent on its variable rate margin loans. It is more competitive on fixed rates with interest paid in advance, particularly for higher value loans where it charges the second lowest rate in the market on fixed rate loans for sums over \$500,000, Canstar Cannex's figures show.

The cost to the customer is especially important where market returns are flat, ANZ Bank's head of equity lending David Crundall says.

"If you've got a market that is growing there seems to be less concentration on the cost of funds but when the capital growth is not there and you're more dependent on the dividend yield or distributions from a managed fund, then the cost of funds does become an issue," he says.

Often if clients want to borrow to invest, financial planners will recommend other forms of leverage, says David Kennedy, director of advice and strategy at Pacific Advisory Wealth Management, which is licensed by Hillross Financial Services.

"From our perspective it's usually just a strategic discussion with the client about where margin lending could fit and then benchmarking that against what are their other options," Kennedy says. "If leverage makes sense for you, you've got the risk appetite, you've got the spare cash flow, you're at an appropriate life stage, we say margin lending is one option, but how does it stack up against home equity lending or internally geared investments?"

"When you've got interest rates going up to where they are now, close to 10 per cent, it has a real impact on the modelling when you put that side by side with home equity lending and give the client a scenario analysis."

In situations where margin lending is the right choice for the client, the adviser must then choose between providers.

Kennedy says that he conducts research and due diligence in determining which margin lending provider to recommend to the client, similar to what he would do when recommending an investment or insurance policy.

"You're running a detailed analysis of features and benefits of the available margin loans. In our case with Hillross

we have a selection of four margin lending providers on our approved product list – Leveraged Equities, St George, Colonial and BT – which isn't to say we can't recommend something which is off that list but to do so we require one-off approval," he says.

Hillross does research on the providers included on its list but Kennedy says researchers' ratings of margin lending products also have an influence on his recommendations. Comparison sites such as Canstar Cannex can provide a snapshot of the features of each product side-by-side. "Interest rate is the primary differentiator but that research can allow you to arrive at a very quick conclusion if there are different variables that you're not sure about," Kennedy says.

Aside from cost, Kennedy looks at the range of approved securities that the lenders have on their lists.

That is a common factor for advisers comparing between lenders. Investment Trends' research showed that 68 per cent of advisers were concerned with the range of shares and managed funds approved by the lender.

BT Margin Lending, NAB Equity Lending and St George Margin Lending each have about 1100 managed funds and more than 400 shares on their approved securities lists. Bank of Queensland, Colonial Margin Lending and Commsec, and Leveraged Equities have about double that number of managed funds and slightly more shares. ANZ has almost 900 managed funds on its approved list and a similar number of Australian shares.

The loan-to-value ratios allowed on these securities varies between providers. The average loan-to-value ratio across NAB's approved securities list is 67.43 per cent, according to Canstar Cannex's figures. Commsec and Colonial Margin Lending have the highest average LVR on managed funds at 73.25 per cent each.

At the start of a gearing strategy, few clients would come close to reaching the maximum LVR allowed by the lender. Across the market, the average gearing level is about 34 per cent. Up until December 2007, average gearing levels had been close to 50 per cent.

However, having a higher LVR can provide a benefit as it gives a greater buffer before a margin call would be made.

ANZ's Crundall says another feature that appeals to advisers is a "reward" of higher LVRs if the portfolio is diversified across a range of stocks and funds rather than a single investment.

"It may not even be about gearing up the maximum – it's definitely not about that – but it's giving you extra protection against margin calls," he says.

Advisers also value a consistent LVR policy from margin lenders, says Jason Ennels, the director of self-licensed advice business Open Financial Services.

"The last thing you want is a lender changing the ratios on you with their exposure to a fund manager or an equity.

"You might have someone who borrows at 50 per cent on BHP and then all of a sudden the ratio is dropped to 30 per cent. That can leave the clients in a very awkward position," he says.

"You want to make sure you're dealing with [a lender who] isn't constantly chopping and changing their ratios, in other words they're not too aggressive to begin with and they don't change them just for the sake of it."

During the market downturn in 2007 and 2008, several lenders reduced or withdrew the lending ratios on securities.

While none of Ennels' clients were affected by these changes, he says he could understand how that could have caused problems, particularly if the client had been gearing aggressively.

Flexibility is another important factor for advisers in selecting a margin loan, as is administrative support. According to Canstar Cannex, each of the margin lenders on the list offer instalment gearing, online support systems for advisers, "what-if" calculators, and can provide a statement to the adviser on request.

Several lenders have their loans integrated with other banking services, trading systems and investment platforms.

Of advisers surveyed by Investment Trends, 54 per cent wanted margin loans to be integrated with the investment platforms that they used. The research also showed that accurate administration was a key consideration for two thirds of advisers recommending margin lending to their clients and up-to-date information on clients' positions was essential for just over half of advisers.

"With a lot of advisers, investment platforms are their bread and butter so having a platform that can interact with the margin loan is critical," says Adrian Handley, head of equity lending at National Australia Bank.

Advisers want to be able to buy and sell equities using a margin loan without having to go through the lender each time for approval. They want the borrowing to be automatically validated.

NAB is working on integrating margin lending into the MLC Wrap. It expects to release the upgrade this year.

The margin loans are already linked with stock brokers' systems. Handley says such interfaces are essential when markets are volatile and investors want to be able to place orders in the market quickly.

For advisers, who typically recommend margin lending as part of a longer term strategy, Handley says the main benefit in having a loan that is integrated with a platform is that it makes the process easier to manage and more scalable.

"It makes it more cost effective to run the business and cost savings can be put back to the client," he says.

It also helps with monitoring the client's portfolio as portfolio pricing is updated every 15 minutes rather than at the end of the trading day.

Advisers expect that the provider invests in their systems and creates products that are sustainable. Provider risk has become a key consideration for advisers like Ennels.

"The main thing we look for is the name behind [the loan], who the lender is. I don't like the idea of a client's loan portfolio being sold to someone else. We usually look for big names," he says.

Following the collapse of lenders Opes Prime and Tricom Securities, Ennels says his business is paying more careful attention to the way that the security is held even though his clients were not affected by the companies' failures. Before those disasters, Ennels says he had no idea that could even happen so those incidents have made him more aware of the risks.

"We don't want a situation where clients are signing over security and guaranteeing loans to a stockbroker. That's one of the reasons that we make sure we stick with a big lender and even after that we still want to see who maintains control of the assets."

Ennels says clients accept that they take on investment risk when they buy shares or managed funds. It's the adviser's job to make sure they understand that if the stockmarket falls, they will lose money and the losses will be magnified if they're borrowing to invest. They also have to help the clients accept the fact that they may receive a margin call and be prepared with a strategy to accommodate that possibility.

"What clients aren't prepared to accept is if I borrow money using shares, even if I'm not in default, that my money is gone because some stockbroker lent too much across their other client portfolios and made bad investment decisions.

"Certainly now we make a point of making sure that clients have no ill effects of something like that," he says.

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