The Association of Superannuation Funds of Australia Limited
ABN 29 002 786 290
ASFA Secretariat
PO Box 1485, Sydney NSW 2001
p: 02 9264 9300 (1800 812 798 outside Sydney)
f: 1300 926 484
w: www.superannuation.asn.au

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Manager
Financial Services Unit
Retail Investor Division
The Treasury
Langton Crescent
PARKES ACT 2600

Email: instalmentwarrantcorpregs@treasury.gov.au

Dear Sir/Madam,

Exposure Draft – Corporations Amendment Regulations 2012 (No.) – Limited Recourse Borrowings by Superannuation Funds (Instalment Warrants)

The Association of Superannuation Funds of Australia (ASFA) would like to provide this submission in relation to the draft *Corporations Amendment Regulations 2012* that deems limited recourse borrowing arrangements (LRBA) entered into under section 67A of the *Superannuation Industry (Supervision) Act 1993* (SISA), to be financial products.

About ASFA
ASFA is a non-profit, non-political national organisation whose mission is to protect, promote and advance the interests of Australia's superannuation funds, their trustees and their members. We focus on the issues that affect the entire superannuation industry. Our membership, which includes corporate, public sector, industry and retail superannuation funds, plus self-managed superannuation funds and small APRA funds through its service provider membership, represent over 90% of the 12 million Australians with superannuation.

General comments on the exposure draft
ASFA supports the intent of the proposed amendments that seek to increase consumer protection. We consider that the overall effect of the Regulations will be to increase the quality of advice provided about LRBAs and perhaps to increase the level of understanding of these arrangements among SMSF trustees.

However, we see the amendments in their current form as being over complicated and excessively focused on instalment warrants as opposed to what has evolved from the now repealed section 67(4A) of SISA.

In particular the proposed licensing requirements that necessitates a derivative or securities license fails to recognise that LRBAs are no longer simply about instalment warrants, but instead involve a number of assets, in particular property.

Specific Comments

1. Apparent conflict between the Principle Regulations and the Explanatory Memorandum

ASFA believes that the terms and effects of paragraph (b) of sub-regulation 7.1.04(H)(2) to be in conflict to Item 2 of the Explanatory Memorandum (EM) that refers to sub-regulation 7.1.06(2A).

New sub-regulation 7.1.04H(2) in defining the meaning of *issued* and *issuer* in relation to a LRBA states at paragraph (b) of that sub-regulation:

> "Each party to the arrangement is an issuer of the product".

New sub-regulation 7.1.06(2A) states:

> "An arrangement relating to the acquisition of an acquirable asset under section 67A or 67B of the *Superannuation Industry (Supervision) Act 1993* is not a credit facility."

Item 2 of the Attachment to (EM) attempts to clarify the insertion of new sub-regulation 7.1.06(2A). It states that:

> "Item [2] would insert a new sub-regulation 7.1.06(2A) in the Principal Regulations. This sub-regulation would prevent persons that merely provide credit as part of a limited recourse borrowing arrangement from being caught by the new requirements."

New sub-regulation 7.1.06(2A) provides only that a LRBA is not a credit facility within the meaning of the *Corporations Regulations 2001*. However the EM provides a broader interpretation by exempting from the new arrangements anyone who merely provides credit as part of the LRBA.

This appears to conflict with sub-regulation 7.1.04(H)(2) that deems "each party to the arrangement to be an issuer of the product" and therefore subject to the new licensing arrangements.

ASFA recommends that there be greater clarity in regards to what, if any, acts or processes in relation to the establishment of a LRBA is exempt from the new law.

2. Is the definition of *issuer* too broad in sub-regulation 7.1.04H(2)?

The breadth of the changes proposed by sub-regulation 7.1.04H(2) may cause difficulties for the SMSF trustee(s), the trustee of the holding trust under the LRBA (Property Trustee) and potentially a member providing a loan or a guarantee, who all would, prima facie, have the obligations of an issuer of a financial product under an ordinary LRBA.

These obligations include:

(a) preparation of a Product Disclosure Statement (PDS) under section 1013A of the *Corporations Act 2001* (Corporations Act); and

(b) provision of a PDS when they issue or offer to issue a LRBA under section 1012B of the Corporations Act. It may be that each party described above would be required to give a PDS to certain of the other parties to the LRBA.

A SMSF trustee would not be required to give a PDS to a financial institution lending to it under section 1012B of the Corporations Act because the financial institution would be unlikely to be a retail client. However, the SMSF trustee may be required to provide a PDS where a member of the SMSF or another person, who met the definition of a retail client, was the lender. Similarly, the SMSF would appear to be required to provide a PDS to the Property Trustee and the Property Trustee to it.

We note that SMSF trustees are exempt by section 1012DA of the Corporations Act, from the requirement to provide a PDS to members about their interest in the SMSF if they believe that the member is aware it has access to all information that the PDS would be required to contain. A similar exemption should be provided in respect of PDSs for issuers of LRBAs that are not intended to be caught.

It is unclear whether a Property Trustee will be a product issuer under a LRBA. Proposed sub-regulation 7.1.04J states that a custodial or depository service (either as defined in section 766E of the Corporations Act) or of any other kind, is not declared to be a financial product.

This exception appears intended to prevent a Property Trustee under a LRBA from being required to fulfil the duties of a financial product issuer. However, given that the Property Trustee will be a party to the LRBA (because it must enter into an agreement pursuant to which it holds property for the benefit of the SMSF), it will still be an issuer pursuant to proposed sub-regulation 7.1.04H. Accordingly, it appears that the Property Trustee will still be required to fulfil the obligations of a product issuer discussed above.

ASFA appreciates and supports the consumer protection objectives of the proposed amendments. However, we feel that that there needs to be greater clarity of who is and is not caught be the new law.

3. <u>The relevant Australian Financial Services License (AFSL)</u>

Further to point (3) above, proposed regulation 7.6.01AB provides that an AFSL which covers the provision of a financial service in relation to a "security" or a "derivative" is taken to cover LRBA under sections 67A and 67B of SISA.

ASFA's understanding is that the main asset acquired under a LRBA to be property. To therefore align the relevant AFSL with that of a securities or derivatives dealer appears to be incongruous. Certainly in the early days of instalment warrants the asset being acquired was a security. However, this has now evolved through the repealed section 67(4A) and today's sections 67A and 67B of SISA to be a LRBA over (potentially) a variety of assets the main one being property.

In fact the ATO ruling SMSFR 2011/D1 – *Limited recourse borrowing arrangements application of key concepts*, list a number of examples all involving property and machinery as investments that best encapsulate LRBAs.

4. <u>Where further guidance is needed</u>

ASFA believes that the exposure draft would be enhanced by the provision of further guidance about a number of issues that are highly relevant to the deeming of LRBAs as financial products. In particular:

(a) Guidance is needed as to whether any PDS required to be prepared for LRBAs may be in a tailored short form, as is the case with, for example, margin lending facilities and some superannuation products, and
(b) There is no discussion as to whether there will be any responsible lending requirements placed on lenders under LRBAs (similar to those placed on providers of margin loans under Division 4A of the Corporations Act).

In conclusion ASFA supports the principle objective of the Regulations (i.e. making LRBAs financial products and therefore subject to the requirements of the Corporations Act). ASFA considers that the overall effect of the Regulations will be to increase the quality of advice provided about LRBAs and perhaps to increase the level of understanding of these arrangements

amongst SMSF trustees. Nevertheless, ASFA also maintains there is some room for improvement in the overall process.

5. Incorrect reference in the EM to section 67(4A)

The reference to section 67(4A) of SISA at Item 2 of the EM is incorrect. The reference should be section 67A or 67B of SISA.

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We thank you for providing us with the opportunity to make this submission and to participate in the consultation process.

If you have any queries or comments regarding the contents of our submission, please contact Tony Keir, Policy Communications and Reporting Manager on (02) 8079 0815 or by email tkeir@superannuation.asn.au

Yours sincerely
Margaret Stewart

General Manager, Policy and Industry Practice