THE TAX INSTITUTE

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By email: instalmentwarrantcorpregs@treasury.gov.au

Dear Ms Calder

Exposure Draft – Corporations Amendments Regulations 2012 – Limited Recourse Borrowings by Superannuation Funds (Instalments Warrants)

The Tax Institute (TTI) welcomes the release of the Exposure Draft – *Corporations Amendment Regulations 2012 (No.)* – Limited Recourse Borrowings by Superannuation Funds (Instalment Warrants) (Exposure Draft) and the accompanying Explanatory Memorandum. TTI makes the following comments by way of submission in respect of the Exposure Draft:

1. The Explanatory Memorandum states that the purpose of the Exposure Draft is to bring the Limited Recourse Borrowing Arrangements (LRBA) by superannuation funds into the government's financial consumer protection framework. TTI agrees that this is an appropriate purpose, but submits that the Exposure Draft casts the net too widely and in its current form would require many more entities to be licensed in order to enter into LRBAs than would seem to be necessary having regard to the nature of the various forms of these arrangements.

2. The Explanatory Memorandum suggests that LRBAs 'involve an up front payment to the issuer with the balance being repaid in periodic instalments'. Whilst this may be a character of certain products – in particular instalment warrants – it is not a necessary, nor even a common, substantive characteristic of many LRBAs, especially those involving self managed superannuation funds (SMSFs). Many arrangements which fall under the LRBA provisions will not involve an up-front payment to an 'issuer' or the periodic repayment of instalments to that issuer. Instead, these arrangements will typically involve the SMSF acquiring an asset from a third party (which may be a related party in some instances), separately arranging a loan from a financier (which again may in some cases be a related party, and in other cases will be an arm's length financier - typically a bank), and the repayment of that loan in due course and according to the terms of the loan. The Explanatory Memorandum suggests that the regulations are intended only to cover a limited form of LRBA: namely an instalment warrant arrangement. We are unclear as to what is intended by this comment, however we note that the draft regulations are drawn widely to

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cover all forms of borrowings under section 67A or 67B of the *Superannuation Industry (Supervision) Act 1993* (Cth) (SIS Act). We submit that if the draft regulations are meant to cover only the traditional form of instalment warrants and similar products, they should be re-drafted to limit their scope to such arrangements.

3. The proposal that the draft regulations would make LRBAs financial products is tentatively welcomed, provided that the requirement to be licensed which follows as a consequence does not extend beyond that which is necessary to provide protection for the consumer; which in the case of the LRBA is the trustee of the superannuation fund. In this regard we note and endorse the submission made by the Superannuation Committee of the Law Council of Australia (attached at Appendix A) to the effect that the draft regulations should target only those LRBA's that are being "promoted" and not private 'one-off' arrangements.

4. TTI agrees with the proposal under the draft regulations that borrowing arrangements be expressly excluded from the concept of "credit facilities" under the Corporations Act where they are entered into by superannuation funds.

5. The suggestion in the Explanatory Memorandum that LRBAs are defined in section 67A and 67B SIS Act is incorrect. Those sections do not contain a specific definition of an LRBA. Instead, those sections prescribe certain circumstances which must exist in order that the general borrowing prohibition in section 67 SIS Act does not apply. The draft regulations themselves correctly refer to the LRBA not as an arrangement defined in sections 67A and 67B, but rather as '*an arrangement relating to the acquisition of an acquirable asset*' under section 67A or 67B of the SIS Act (regulation 7.1.04H(1)). The draft regulations cover any form of LRBA whether a specific instalment warrant type product which appears to be contemplated by the Explanatory Memorandum, or any other arrangement which falls within section 67A or 67B SIS Act.

6. Proposed regulation 7.1.04H(2)(b) provides that 'each party to the arrangement is an issuer of the product'. As a consequence, each party to the arrangement would need to be licensed (subject to any future 'carve out' that might remove the requirement to be licensed). Participants under an LRBA would typically include:

    a. the trustee of the superannuation fund which is entering into the LRBA;

    b. the (security) trustee of the holding trust as contemplated under section 67A(1)(b) SIS Act;

    c. the lender to the superannuation trustee; and

    d. any other person who has rights against the trustee of the superannuation fund for, or in connection with, or as a result of, default on the borrowing (section 67A(1)(d) SIS Act) (e.g. a guarantor of the borrowing).

7. Each of these participants would be an issuer under the proposed regulations. In particular, we note that the carve outs under regulation 7.1.04J(2) for a custodial or depository service and a custodial or depository arrangement and a related administrative service or arrangement do not go far enough to exclude the need for a licence by the security trustee. Further clarification is required because a security trustee is doing very little apart from being the registered owner of the legal title to real estate or shares or other "acquirable assets". Again, we note and endorse the submissions by the Superannuation Committee of the Law Council of Australia to the effect that the issuer of an LRBA should be defined as the "promoter" of the LRBA which would address our concerns.

8. An example of typical LRBA arrangement might involve the following:

    a. a company - XYZ Pty Ltd - acts as trustee of the XYZ Superannuation Fund. The fund has one member, Mr X;

    b. XYZ Pty Ltd, in its capacity as trustee of the fund, wishes to acquire a residential property using an LRBA. It proposes to do so by borrowing from ABC Pty Ltd, a private company controlled by Mr X. HoldCo Pty Ltd would be incorporated to act as trustee of the holding trust. HoldCo would hold the legal title in the property, and the beneficial interest would be held by XYZ Pty Ltd as trustee of the fund;

    c. Mr X proposes to provide a limited personal guarantee to support the borrowing by the trustee of the superannuation fund.

9. Under this scenario, having regard to the draft regulations, potentially each of XYZ Pty Ltd, ABC Pty Ltd, HoldCo Pty Ltd and Mr X are parties to the LRBA, and therefore 'issuers'. Consequently all of these entities would need to be licensed in order to satisfy the requirements of the Corporations Act (assuming there is an argument that they are carrying on a financial services business in Australia – which may we note may be the case even where only a single transaction is involved).

10. Whilst TTI agrees that it is appropriate that those promoting and giving advice to consumers proposing to enter into LRBAs be licensed, and that issuers of stand-alone products (such as traditional instalment warrants) should also be licensed, requiring the superannuation trustee, security trustee and other private participants in the LRBA to be licensed, particularly where they are parties related to the trustee of the superannuation fund and its members, appears to be both unnecessary and not the policy intention.

11. We do not believe that appropriate consideration has been given to the flow on implications from the proposed regulations such as the impact on who will need to provide a product disclosure statement (PDS) and in what form it will need to be given. For instance, would multiple PDSs be required? Further, what, if anything, would need to be expressed in the PDS regarding the particular "acquirable property" which is the subject of the LRBA?

12. TTI also has concerns about the proposed "securities" and "derivatives" authorisations as not being appropriate to cover LRBAs. We consider that

"superannuation" would be a more appropriate authorisation at least as far as SMSF related LRBAs are concerned.

13. The TTI has concerns that its members and their clients will not benefit from the proposed changes as they will only add an additional cost to the typical LRBA that SMSFs undertake in respect of the acquisition of real estate which we consider is already sufficiently regulated. We submit that the traditional 'instalment warrants' that involve shares, managed investment funds and like collective investments that are issued to consumers should be the target of these changes. Further, we do not have any concern with the proposed draft regulations seeking to regulate persons promoting LRBAs who are otherwise unregulated. However, the typical SMSF LRBA for the acquisition of real estate and the attendant taking out of a loan should, in our view, be "carved out" from the definition of "financial product" at least as far as it impacts upon the superannuation trustee, a security trustee and a lender in a private SMSF LRBA.

14. TTI submits that the better approach would be to require unrelated parties to the LRBA, including those giving advice in relation to the arrangement and those involved in the promotion of the arrangements, to be licensed along with issuers of stand-alone traditional instalment warrant products, but otherwise not require the individual participants to be so licensed.

15. We suggest that consideration also be given to these new requirements when changes to the "accountants exemption" are being reviewed as there would be likely to be some degree of overlap in this area.

If you would like to discuss this matter, please contact me on 02 8223 0011 or The Tax Institute's Tax Counsel, Deepti Paton, on 02 8223 0044.

Yours sincerely

Ken Schurgott
President