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Mr Warwick Walpole
Manager, Financial Services Unit
Retail Investor Division
The Treasury
Langton Crescent
PARKES ACT 2600

Dear Mr Walpole,

Limited recourse borrowing arrangements

The Australian Bankers Association (ABA) welcomes the opportunity to provide comments on the revised exposure draft regulations to amend the *Corporations Regulations 2001* to provide that:

- limited recourse borrowing arrangements are financial products under the *Corporations Act 2011* when acquired by superannuation funds;
- limited recourse borrowing arrangements are not a credit facility under the Corporations Act when acquired by superannuation funds; and
- an Australian Financial Services Licence covering securities or derivatives is taken to also cover limited recourse borrowing arrangements.

The ABA appreciates that the initial proposed regulations have been amended to take account of some issues raised by the banking industry. While the ABA supports implementing reforms to ensure self-managed superannuation funds (SMSFs) receive appropriate financial product advice from qualified and professional advisers, we are concerned that the revised exposure draft regulations continue to contain legal and regulatory issues that would significantly impact on banks' commercial operations and compliance systems as well as the functioning of markets and the ability for SMSFs to access structured geared arrangements to build wealth. It is essential that the proposed regulations apply the existing financial services and consumer credit laws to these various arrangements appropriately.

1. Opening comments

The ABA notes that superannuation funds are not permitted to borrow except in limited circumstances prescribed by the *Superannuation Industry (Supervision) Act 1993* (SIS Act). Limited recourse borrowing arrangements, such as instalment warrants and limited recourse loans, are permitted under sections 67A and 67B of the SIS Act and are generally used by SMSFs.

The ABA believes that regulation of limited recourse borrowing arrangements should be made on the basis of the nature of the structure, rather than applying a broad extension of obligations to all forms of limited recourse borrowing by regulated superannuation funds. We consider that the existing law is adequate and that it should continue to treat limited recourse loans as "credit facilities", requiring a person who provides credit assistance in relation to the acquisition of an asset under section 67A and 67B of the SIS Act to hold an Australian Credit Licence or be appointed a credit representative. The law should also continue to treat instalment warrants as "financial products", requiring a person who provides financial product advice on instalment warrants (in relation to the acquisition of an asset under section 67A and 67B of the SIS Act or otherwise) to hold an Australian Financial Services Licence authorising them to provide financial product advice in relation to a security or a derivative or be an authorised representative.

2. Specific comments

2.1. Making a distinction between limited recourse borrowing arrangements

The ABA believes that the revised exposure draft regulations do not adequately acknowledge existing legal obligations and consumer protections or adequately address the distinction of types of arrangements – that is, not all limited recourse borrowing arrangements are financial products. We consider that instalment warrant structures and limited recourse loan arrangements should be regulated under existing financial services and consumer credit laws, respectively. Specifically, the law should:

- Not regulate limited recourse loans to a superannuation fund under Chapter 7 of the Corporations Act. Loans should continue to be regulated as "credit facilities" and separate to instalment warrants, which should continue to be regulated as "financial products". As currently drafted, the proposed regulations would have a significant impact on banks' compliance systems and procedures, business structures, adviser and distribution networks, due diligence and credit assessment processes as banks would be required to treat some loans as financial products while most other loans would be regulated by the *National Consumer Credit Protection Act 2009* or be unregulated. Without clarifying limited recourse loans as being regulated as "credit facilities", banks will face complex compliance obligations where loans will be regulated under different legal regimes depending on whether the loan is made to a superannuation fund or other entity/individual.
- Recognise that arrangements may be made for SMSFs to purchase an acquirable asset other than under instalment warrants, e.g. real property, and apply obligations accordingly. These transactions are typically unique – limited recourse loans require individual decisions about serviceability, structure of trust, type of security, quality and valuation, guarantor arrangement, and do not naturally fit into product statement disclosure (PDS) requirements. It is unclear given the tailored nature of the arrangements how a PDS could adequately disclose the risks and key features, and in particular if a PDS is required to make disclosures about the merits of acquiring the property.
- Recognise the significant changes introduced by the *National Consumer Credit Protection Act 2009* and the pending changes to be introduced by the FOFA reforms requiring financial advisers, credit assistance providers, finance brokers and accountants to implement new compliance systems and procedures. We consider these laws provide adequate regulation, and in particular the FOFA legislation with regards to limited recourse borrowing arrangements treated as "financial products" under the Corporations Act. We note that investment decisions and lending decisions should be retained by those with appropriate qualifications and skills.
- Clarify the relevant retail/wholesale distinction' test. We note that the definition of a "retail client" (including the application of the 'retail/wholesale distinction test' to superannuation entities) is currently under consideration by Treasury. We suggest that the proposed regulations not be finalised until the definition of retail client is finalised. This approach will allow banks to fully assess how the changes will impact on their current operations and make the necessary amendments. A further distinction would be problematic in terms of compliance systems, and ultimately undermine the ability for banks and other providers to appropriately manage the various business and operational risks.

2.2. Preventing legal uncertainty and unnecessary regulatory burden

The ABA believes that the revised exposure draft regulations should not create legal ambiguities or impose unnecessary compliance obligations and costs on banks and other providers. Specifically, the law should:

- Avoid imposing obligations on parties entering into a legal relationship that sets up an arrangement (as in practice, in relation to a real property transaction, the parties would be the purchaser and the vendor) and clarify the timing of when a person enters the arrangement. Conduct and disclosure obligations and competency requirements should be appropriately assigned depending on the type of arrangement. We note that the concept of the "issuer" of the product is irrelevant with limited recourse loans and may create confusing obligations on multiple parties to the arrangement. For example, under the current proposed regulations the issuer may be one or more of the lender, superannuation trustee, security trustee, administrators, financial advisers, finance brokers, real estate agents or conveyencing lawyers.
- Exempt persons merely arranging or providing credit as part of a limited recourse borrowing arrangement.

- Treat financial product advice about the acquisition of an asset under section 67A and 67B of the SIS Act to be a financial service in relation to a financial product (assuming the asset is a financial product).
- As noted above, treat 'limited recourse loans' a "credit facilities" (requiring a person who provides credit assistance in relation to the acquisition of an asset under section 67A and 67B of the SIS Act to hold an Australian Credit Licence or be appointed a credit representative) and "instalment warrants" as financial products (requiring a person who provides financial product advice in relation to the acquisition of an asset under section 67A and 67B of the SIS Act to hold an Australian Financial Services Licence authorising them to provide financial product advice in relation to a security or a derivative or be an authorised representative).

2.3. Commencement date and transitional provisions

The ABA is concerned that the proposed regulations do not provide sufficient time (i.e. 3 months) to enable changes to be implemented, especially given the potentially significant changes the proposed regulations would require for banks to continue to offer arrangements to SMSFs (i.e. obtaining or varying licensing arrangements, preparing regulatory documentation, implementing new compliance systems and procedures, ensuring staff training, etc). Furthermore, we note that the banking industry is currently undergoing substantial changes and is being required to implement extensive new compliance systems and procedures due to other legal and regulatory reforms. We consider that a transitional period of 12 months is required for banks to introduce new compliance systems and procedures.

3. Concluding comments

The ABA believes that it should be appreciated that the revised exposure draft will, despite some amendments, still have considerable implications for borrowing within the superannuation industry.

Yours sincerely,

Diane Tate