ING DIRECT
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9 March 2012

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

Dear Mr Walpole

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

ING DIRECT, a division of ING Bank (Australia) Limited (**ING DIRECT**) is an authorised deposit-taking institution (**ADI**) that has been operating since it obtained its banking licence in 1994. ING DIRECT is part of the global ING Group. ING DIRECT offers a range of products and has more than 1.4 million customers with $26 billion in deposits and $38 billion in mortgages.

ING DIRECT welcomes the opportunity to comment on the proposed amendments to the *Corporations Regulations 2001* (**Corporations Regulations**), outlined in the *Exposure Draft - Corporations Amendment Regulations 2012 (No.) - Limited Recourse Borrowings by Superannuation Funds (Instalment Warrants)* (**Proposed Regulations**).

1. Background

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 self-managed superannuation funds (**SMSF**)[1]. The Proposed Regulations intend to amend the Corporations Regulations to provide that:

- all limited recourse borrowing arrangements are financial products under the *Corporations Act 2001* (Corporations Act) when acquired by superannuation funds;
- a limited recourse borrowing arrangement is not a credit facility under the Corporations Act when acquired by superannuation funds; and
- an Australian Financial Services Licence (AFSL) covering securities or derivatives is taken to also cover limited recourse borrowing arrangements.

2. Summary

ING DIRECT appreciates the Government's focus on extending consumer protections to superannuation funds, to try to regulate sophisticated products and ensure SMSF trustees do not receive inappropriate advice before entering a limited recourse borrowing arrangement from unlicensed or unqualified dealers.

[1] We note that this submission refers mainly to SMSF rather than other superannuation funds as these funds are more likely to be involved in this type of limited recourse borrowing arrangements.

However, the main issue with the Proposed Regulations is that the vehicle enabling superannuation trustees to acquire "acquirable assets", i.e. the credit facility, will be a "financial product" under the Corporations Act. In our view, there is a ***distinct difference*** between an instalment warrant, which is akin to a 'terms purchase agreement' and a limited recourse loan offered by ING DIRECT and other ADI's which is clearly more akin to a credit facility rather than a financial product. This difference should be distinguished in the final regulations.

In addition, we note that as currently drafted, the Proposed Regulations will mean:

- each "party" to the limited recourse borrowing arrangement will be an "issuer" - i.e. potentially including the superannuation trustee, the security trustee and the lender. This would further complicate the arrangement in terms of disclosures and liability and lead to higher costs and a reduction in banking competition in relation to the arrangements;

- the timing of "when the person enters into a legal relationship that sets up the arrangement" is not clear and may cause confusion, especially considering that multiple parties will be involved;

- the commencement will be three months after the regulations are made - given the volume of regulatory and legislative change currently facing the superannuation industry, this timing may cause industry participants to rush to comply without properly considering the issues and not having adequate time to prepare the necessary documents.

3. ING DIRECT Submission

3.1 Difference between 'instalment warrants' and other limited recourse loans

The Proposed Regulations treat all arrangements made under section 67A or 67B of the SIS Act as "financial products" under regulation 7.1.04J (1). Although both 'instalment warrants' and other 'limited recourse loans' may be made under section 67A of the SIS Act, there is a distinct difference between a true instalment warrant and a simplified limited recourse loan currently offered by ADI's.

An 'instalment warrant' is effectively purchasing an asset such as real property or shares on 'lay-by', where the purchaser makes an upfront payment to the issuer and then makes periodic instalments to repay the balance over time. This arrangement may be established through a single transaction. We note that many product issuers have long formed the view that 'standard instalment warrants' are already regulated under the Corporations Act as "securities" or "interests in a managed investment scheme" and already provide financial product disclosure.

However, a 'limited recourse loan' currently offered by ING DIRECT and other ADI's is more akin to a true loan and does not require an upfront payment to the lender. Under this arrangement, a SMSF trustee wishing to purchase an "acquirable asset" acquires a loan that is secured by a mortgage from a bare trustee, known as a Property Trustee or Security Custodian. The Property Trustee owns the legal interest to that asset for the term of the loan and the SMSF trustee has a beneficial interest. This arrangement is established through multiple transactions and documents.

In practice, the Property Trustee enters into a contract with a vendor to purchase an acquirable asset (in this case a residential investment dwelling). The SMSF trustee pays the deposit to the vendor, and the SMSF trustee then enters into a loan arrangement with an ADI or other lender to complete the purchase. During the term of the loan, the SMSF trustee makes the loan repayments to the ADI or other lender and once the loan is repaid, the SMSF trustee may arrange for the legal interest in the asset to be transferred for its benefit.

Acquiring the 'limited recourse loan' is merely one transaction within the arrangement, i.e. a credit facility to facilitate the SMSF trustee's acquisition of an "acquirable asset".
In line with this reasoning, the Proposed Regulations include sub-regulation 7.1.06(2A). The Explanatory Memorandum provides "[t]his sub regulation would prevent persons that merely provide credit as part of a limited recourse borrowing arrangement from being caught by the new requirements."

However, as it is currently drafted, this sub-regulation provides that any limited recourse borrowing arrangement made under sections 67A and 67B of the SIS Act is not a credit facility. In our view, the intention behind this provision (as explained in the Explanatory Memorandum) is not reflected in the sub-regulation and therefore, requires amendment to clarify that an entity merely providing credit as part of a 'limited recourse borrowing' is not subject to the provisions under regulation 7.1.04J.

We recommend that:

- proposed regulation 7.1.04J is amended to clarify that this provision only applies to 'instalment warrants' rather than all arrangements made under sections 67A and 67B of the SIS Act; and

- proposed sub-regulation 7.1.06(2A) is deleted or amended to allow 'limited recourse loans' to continue to fall within the definition of "credit facility" and be excluded from being a financial product under the Corporations Act.

3.2 Concerns with multiple "issuers"

Proposed sub-regulation 7.1.04H (2) (b) provides that each party to the arrangement is an "issuer" of the product. This means that the SMSF trustee, the Property Trustee, the lender, the guarantor (if any), the issuer of the "acquirable asset" and any other parties involved in the arrangement would be deemed an "issuer".

The basis for this is explained in the Explanatory Memorandum, which states "because a limited recourse borrowing arrangement involves numerous parties, it is difficult to determine which party is the "issuer" or when the product is "issued"."
In terms of exemptions from this provision:

(a) it is likely that a SMSF trustee will be exempted from the requirement to hold an AFSL under Corporations Regulation 7.6.01(1) and potentially Class Order 02/1161, as it would be dealing in a financial product in its capacity as a trustee, and on behalf of members, of a non-public offer superannuation fund. However, from a practical perspective, the idea that a SMSF trustee who is acquiring a loan is also the issuer of that financial product is not logical;

(b) it is possible that a Property Trustee may be exempted from providing a financial product where it provides any "custodial or depository service" or "administrative service" associated with that service. However, this will depend on the nature of the services provided.

However, a lender would still be deemed to be an "issuer" under the Proposed Regulations and would be required to comply with the relevant consumer protection requirements under the Corporations Act, more so than other entities involved in the arrangement.

While some lenders promote and arrange these structures, this is generally ***not*** the case. In most cases, the ADI or other lender is merely providing a credit facility for the SMSF trustee to enable it to acquire the "acquirable asset". While the lender understands the context of the loan and is best placed to explain the terms of the loan, it generally requires only enough information about the borrower and investment structure to assess the loan as it would any other business loan.

In our view, deeming the lender an "issuer" and requiring the lender to prepare a product disclosure statement (**PDS**), obtain appropriate indemnity insurance and become a member of an external dispute resolution scheme would further complicate these arrangements. This would likely lead to higher costs that will be passed on to SMSF trustees and a reduction in banking competition as some lenders may cease offering these products as the cost of compliance is too great.

In terms of the advice provided and the promotion of the structure, an ADI (or its representative) would generally provide advice to the SMSF trustee in relation to the terms of the loan, which may amount to broking services. However, it would not provide advice or any recommendation in relation to the investment structure.

It is more likely that an accountant or financial adviser would provide "financial product advice" in relation to the structure and would assist in arranging the components of the investment. It is for this reason that many lenders require a certificate that states that the SMSF trustee (the member of the SMSF) has obtained independent financial advice prior to applying for the loan.

We recommend that:

- Proposed Regulation 7.1.04H is amended to clarify the "issuer" to be the entity that substantially arranges the structure, rather than each party to the arrangement; and

- the Proposed Regulations are amended to clarify the distinction between a person who provides "financial product advice" in relation to the structure of the arrangement, who would be subject to the new regulations, and a person who only provides broking services in relation to a limited recourse loan.

3.3 Other implications - product disclosure and timing

Under the current drafting, Proposed Regulation 7.1.04J requires any entity dealing in, or advising in relation to, any limited recourse borrowing arrangement to comply with the relevant consumer protection requirements for a "financial product", including providing a PDS, Financial Service Guide, Statement of Advice and various other disclosure documents, depending on a party's role in the arrangement.

Having multiple "issuers" under proposed sub-regulation 7.1.04H (2) (b) would lead to confusion for a SMSF trustee, who may receive multiple PDSs and other regulatory documents relating to the same arrangement. This also raises the question of whether each "issuer" would prepare a separate PDS, and be liable for that information, or whether a joint PDS would be prepared and liability shared between the issuers.

Irrespective of whether multiple PDSs or joint PDSs are prepared, the compliance costs will likely be passed on to the SMSF trustee and the issue of liability will remain unclear, presumably with any action for loss being directed at the lender, the entity with the deepest pockets rather than the entity that advised on the arrangement. The recommendation to clarify sub-regulation 7.1.04H (2) (b) (outlined in section 3.2 above) would also address this issue.

Proposed regulation 7.1.04H (2) (a) provides that the limited recourse borrowing arrangement will be deemed to be issued "when a person enters into a legal relationship which sets up the arrangement". For a 'limited recourse loan' that involves multiple parties and transactions, the timing of "when a person enters into a legal relationship which sets up the arrangement" is unclear.

We recommend that proposed sub-regulation 7.1.04H (2) (a) is amended to clarify when the arrangement is "issued".

3.4 Timing

The Proposed Regulations are intended to commence three months after they are registered. The addition of these changes to the numerous other proposed regulatory and legislative changes in the superannuation industry (such as Stronger Super and Future of Financial Advice) will, in our view, cause industry participants to rush to comply without properly considering the issues. This will also not provide enough time for the industry to prepare licence applications and regulatory documents (if necessary).

We recommend delaying the commencement of the final regulations, to ensure the industry has adequate time to prepare the relevant authorisations and disclosure documents.

4. Conclusion

In our view, as currently drafted the Proposed Regulations do not reflect the Government's stated intention of extending the consumer protections to superannuation funds when purchasing instalment warrants to ensure superannuation funds do not receive inappropriate advice from unlicensed and unqualified dealers. If anything, the Proposed Regulations provide more uncertainty and complication for SMSF trustees.

We strongly recommend the Proposed Regulations are amended to:

(a) specify the "issuer" of the arrangement under regulation 7.1.04H to be the entity that substantially promotes and arranges the structure, rather than each party to the arrangement;

(b) clarify when an arrangement is "issued" under sub-regulation 7.1.04H(2)(a);

(c) specify in regulation 7.1.04J that the provision only applies to 'instalment warrants' rather than all arrangements made under sections 67A and 67B of the SIS Act;

(d) delete or amend the terms of sub-regulation 7.1.06(2A) to allow 'limited recourse loans' to continue to fall within the definition of "credit facility" and be excluded from being a financial product;

(e) clarify the distinction between a person who provides "financial product advice" in relation to the structure of a borrowing arrangement and a person who merely provides broking services in relation to a limited recourse loan; and

(f) delay the commencement of the final regulations to ensure the superannuation industry can consider their effect and prepare any necessary documents and applications.

ING DIRECT would be pleased to assist the Government in relation to any of the matters raised in this submission, so please do not hesitate to contact Laurie Shaw on 02 9028 4260 or Shivanthi Fernando, on 02 9028 4420 to discuss.

Yours sincerely,

Don Koch
Chief Executive Officer
ING Bank (Australia) Limited