Law Council
OF AUSTRALIA

9 March 2012

Manager
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Retail Investor Division
The Treasury
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PARKES ACT 2600

Email: instalmentwarrantcorpregs@treasury.gov.aau

Dear Sir/Madam,

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

I am pleased to enclose a submission prepared by the Superannuation Committee of the Legal Practice Section of the Law Council of Australia on *Exposure Draft - Corporations Amendment Regulations 2012 (No.) - Limited Recourse Borrowings by Superannuation Funds (Instalment Warrants).*

Due to time constraints this submission has not been considered by the Directors of the Law Council of Australia.

Yours sincerely

Margery Nicoll.

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

The Treasury

Submission by the Superannuation Committee of the Legal Practice Section of the Law Council of Australia

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The Superannuation Committee is a committee of the Legal Practice Section of the Law Council of Australia. Its objectives include ensuring that the law relating to superannuation in Australia is sound, equitable and demonstrably clear. It fulfils this objective in part by making submissions and providing comments on the legal aspects of proposed legislation, circulars, policy papers and other regulatory instruments.

The Committee has set out below its comments on the draft *Corporations Amendment Regulations 2012* (**draft regulations**).

Introduction

The draft regulations will create a new financial product for limited recourse borrowing arrangements which fall within the terms of section 67A or 67B of the *Superannuation Industry (Supervision) Act 1993* (**SIS Act**). The arrangement (the financial product) will be deemed to be issued when "a person enters into a legal relationship that sets up the arrangement" and each party to the arrangement will be an issuer of the product.

The Committee understands that the intention of the regulations is to ensure that trustees of superannuation funds that enter into limited recourse borrowing arrangements enjoy the protection of the Government's financial services laws. This means that issuers of limited recourse borrowing arrangements and advisers who recommend such arrangements will be required to hold an AFS licence or to act as the representative of an AFS licensee. Further, the Committee suspects that the intention of the regulations is to regulate those people who are promoting the arrangements (eg banks, mortgage brokers, real estate agents, accountants). However, the Committee is concerned that if the regulations are made in their current form, they will create an unworkable regulatory regime for those involved in limited recourse borrowing arrangements, in particular the trustees of superannuation funds. The Committee believes that many of these consequences are unintended.

In the Committee's view, the problems with the draft regulations could be remedied without disturbing the intention of bringing such arrangements within the scope of the licensing and disclosure regimes in Chapter 7 of the *Corporations Act 2001* (**Corporations Act**), by:

- introducing a more precise definition of the new financial product; and
- narrowing the class of issuers of the new financial product, preferably to a single issuer.

In particular, the Committee suggests that consideration be given to re-defining a limited recourse borrowing arrangement for the purposes of it being a "financial product" such that it must also be an arrangement that:

> *… is promoted by a person or an associate of a person, who was, when the arrangement was promoted in the business of promoting arrangements relating to the acquisition of an acquirable asset under section 67A or 67B of the SIS Act.*

This additional condition mirrors a similar condition used under the Corporations Act with respect to regulating managed investment schemes (**MIS**) and means that one-off private arrangements are not generally caught by the MIS regime. With the adoption of this condition, consideration might then be given to defining the "issuer" of such a product as the person who is promoting the arrangement.

Whilst not necessarily resolving all issues, the Committee considers that this approach would largely address many of the concerns raised below with respect to the draft regulations.

The Committee has set out below the key problems with the revised draft regulations.

Meaning of "arrangement"

Proposed new regulation 7.1.04J(1) will operate to deem an *arrangement* relating to the acquisition of an acquirable asset under section 67A or 67B to be a financial product. It is conceptually difficult to characterise an "arrangement" as a "product". The breadth of the term arrangement will cause uncertainty about the scope of arrangement – what is part of the arrangement and what is outside its scope and the parties to the arrangement.

An arrangement which satisfies the conditions in section 67A or 67B will typically include many components and various legal persons. In some cases the arrangement may be entered into in a single transaction (eg an instalment warrant) or in a series of transactions (eg a limited recourse borrowing by a trustee to purchase real estate). It may involve a single document (eg an application for nstalment warrants) or multiple documents (eg an application for a loan, a mortgage, guarantees, a security trust deed and a sale agreement).

Each "party" to a limited recourse borrowing arrangement will be deemed to be an "issuer" of the product under proposed new regulation 7.1.04H(2)(b). In the ordinary course a limited recourse borrowing arrangement which satisfies the conditions in section 67A or 67B of the SIS Act will include three "parties": a lender, the security trustee (who must hold the acquirable asset on trust for the superannuation trustee) and the superannuation trustee. Depending upon the nature of the asset to be acquired, the issuer of the acquirable asset (eg the issuer of securities) or the seller of the acquirable asset (eg the vendor of real property) may be a "party" to the arrangement at the time the loan arrangement is entered into or may only be subsequently involved. The arrangement may also include guarantors as "parties" where they provide guarantees to the lender. This means there will likely be multiple issuers of the product, including the recipient of the loan – the superannuation trustee. Due to the breadth of the concept introduced by the draft regulations, the trustee will also be deemed to be issuing a financial product when it borrows money on a limited recourse basis to acquire an asset under section 67A or 67B.

The security trustee will be a party to the arrangement as mentioned above, notwithstanding that they are merely holding an asset on trust (and typically a bare trust) for the superannuation trustee. They will therefore also be deemed to be issuing a financial product when the legal relationship for the limited recourse borrowing arrangement is set up. The Committee notes that proposed regulation 7.1.04J(2)(a) and (b) is to the effect that a custodial or depository service or arrangement, or an associated administrative service, is not declared to be a financial product. While this regulation appears to be intended to prevent a security trustee from being caught as an issuer of the financial product that is the limited recourse borrowing arrangement, by virtue of the breadth of proposed regulation 7.1.04H(2)(b) such security trustees will nevertheless be caught.

In addition to deeming the superannuation trustee and the security trustee to be issuers of a financial product, the draft regulations will also introduce a significant degree of uncertainty as to who else is a party to the arrangement. Is the vendor of land, or the issuer of securities, where they are the acquirable asset, also a "party" to the arrangement? What about any guarantors – are they also to be classified as a "party" to the arrangement? The answer would seem to be that the guarantor is, indeed, a "party",

at least where the guarantee is provided at the same time as the loan is entered into or the mortgage executed.

In the Committee's view, in most situations, it is the lender who is likely to be the most appropriate person to be classified as the "issuer" of the limited recourse borrowing arrangements – ie being, in fact, the issuer of the limited recourse loan to the trustee of the superannuation fund. Lenders will clearly be a party to at least one "legal relationship that sets up the arrangement". This is consistent with proposed regulation 7.1.06(2A) which provides that a limited recourse borrowing arrangement is *not* a credit facility. Under section 765A(1)(h) of the Corporations Act a credit facility is not a financial product. However, the terms and effect of regulation 7.1.06(2A) are in contrast to a statement in the explanatory statement that the regulation prevents someone who "*merely provides credit as part of a limited recourse borrowing arrangement from being caught by the new requirements*". The regulation does not have the meaning expressed in the explanatory statement and will not be effective to exclude a person who merely provides credit from the new requirements. However, if our "promoter" condition as described above were adopted, then clearly a person merely providing credit (and not promoting limited recourse borrowing arrangements) would not be caught. On the other hand, a lender that promoted a limited recourse borrowing arrangement would be caught by virtue of their promotional activities.

The breadth of the concept of "arrangement", both generally and also specifically in the context of section 67A or 67B of the SIS Act, and the potentially large class of issuers of the financial product, not only creates uncertainty but will in turn affect who must hold an AFS licence to issue the product and to provide advice about the product.[1] It will also affect who is required to issue a PDS in respect of the product and the content of the PDS. Where a bank provides a limited recourse loan to a superannuation fund trustee who uses the proceeds to purchase real estate, the Committee questions whether the bank need to include information about the real estate in the PDS. The real estate will be a key feature of the arrangement, it being the asset which is acquired under the arrangement. Except where the limited recourse borrowing arrangement involves a standard instalment warrant where the security forms an integral part of the "product", the Committee suggests that the PDS content requirements should not extend to require details of the "acquirable asset". In this way, there would be no need for the PDS to say anything about the specific acquirable asset that will, in fact, be acquired, where the identity of the asset is not an integral part of the "product" and where, instead, there is flexibility as to what might constitute the acquirable asset. The Committee also notes that in most if not all situations where the bank is the lender and real property is to be acquired, the bank's knowledge of the property will effectively be limited to the matters disclosed in the documents provided to it by the borrower in connection with the loan. It would seem absurd if the bank were required to provide that information back to the person who had initially provided it.

Timing of issue of product

A limited recourse borrowing arrangement will be deemed to be issued "*when a person enters into a legal relationship which sets up the arrangement*": see proposed regulation 7.1.04H(2)(a). The application and effect of this deeming provision is unclear, particularly where the arrangement involves, as it normally will (for the reasons outlined above), more than two parties.

[1] Whilst the Committee accepts that all parties to an arrangement may not be found to be carrying on a financial services business and as a result may not require an AFS licence, the position is far from clear in the context of these transactions and whether a one-off dealing may nevertheless be sufficient to constitute conducting a business. The Committee's preference is that the draft regulations be amended so that questions about whether an arrangement is caught by the Chapter 7 requirements do not arise where there are one-off limited recourse borrowing arrangements and no promoters involved.

AFS licence authorisation

Under the draft regulations licensees who are authorised to deal in or provide financial product advice about "securities" or "derivatives" will not need to apply for a licence or a variation to their licence. It is not clear to the Committee why these would be appropriate authorisations, particularly in the case of a "derivatives" authorisation. A limited recourse borrowing arrangement will not necessarily be a sophisticated product in the way that derivatives often are and there are clearly different skills involved in understanding a limited recourse borrowing arrangement. The Committee also questions the appropriateness of a "securities" authorisation. It is not clear why such an authorisation would be relevant where, for example, the limited recourse borrowing arrangement is entered into for the purposes of acquiring real estate within a superannuation fund. The Committee believes that a more appropriate authorisation would be "superannuation" as the limited recourse borrowing arrangements would at least need to involve a superannuation fund and compliance with section 67A or 67B.

Which PDS requirements apply?

The PDS requirements that would apply to the product that is the limited recourse borrowing arrangement will be the "standard" PDS requirements in section 1013C of the Corporations Act. However, the arrangement may well also involve a margin loan. Where this is the case, the lender will also have to prepare a PDS which complies with the "shorter" PDS requirements for margin loans. The differing requirements will not be able to be satisfied in the one document. The Committee suggests that the regulations clarify that, where there is a limited recourse borrowing arrangement and a PDS must be prepared and given for that product, there is no need to also prepare and give a PDS for any incidental product which forms part of the broader arrangement, for example a margin loan.

PDS requirements for multiple issuers

In addition, the "multiple issuers" situation (lender, mortgage broker, accountant, lawyer, security trustee, superannuation fund trustee, financial planner etc) creates concerns regarding the preparation of the PDS. Is it contemplated that there be a compendium PDS (with multiple issuers and liability issues to be resolved between the issuers) or does each issuer prepare a PDS (which the Committee anticipates would cause confusion) and how will each of those issuers satisfy their "reasonable steps" due diligence?

If the current drafting is not changed the Committee recommends that the regulations be amended so that multiple PDSs for the one arrangement are not required merely because there are deemed to be multiple issuers. If our suggested "promoter" condition is adopted then a PDS would only be required to be issued by the "promoter" for example a bank, a real estate agent or an accountant who is promoting the arrangements and the Committee expects that the PDS would then take on a more generic approach to the kinds of products promoted.

Timing

The regulations are proposed to commence 3 months after registration. This would leave very little time to deal with the licensing and disclosure implications, even if the issues identified above are rectified. The Committee suggests that a longer lead time be adopted, say at least 6 months. This would be more consistent with the lead times normally allowed for significant licensing and disclosure changes of this kind. In particular, a 3 month period in which to obtain an AFS licence, or an additional authorisation to an existing licence, is likely to be very difficult to meet, particularly if ASIC is unwilling to provide any assurances about how quickly it will process applications.

The Committee also suggests that as there may be accountants affected by the introduction of the draft regulations in terms of advice they provide (and may be in the midst of providing) to clients about limited recourse borrowing arrangements under the SIS Act, consideration be given to the impact of the proposed draft regulations in light of the announcements that have been made around changes to the "accountants' exemption" under the Corporations Act.

Conclusion

In the Committee's view the draft regulations need to be amended to clearly identify the parameters of the arrangement which is deemed to be a financial product and to identify with precision the issuer of the product. The Committee considers that there should be a single issuer who will then need to hold the necessary AFS licence and who will be responsible for the PDS. The Committee strongly urges Treasury to give consideration to our suggestion for the introduction of an additional "promoter" condition and the designation of the promoter as the "issuer" which would overcome many of the concerns the Committee has raised whilst still achieving the objective of the draft regulations.

Attachment A: Profile of the Law Council of Australia

The Law Council of Australia exists to represent the legal profession at the national level, to speak on behalf of its constituent bodies on national issues, and to promote the administration of justice, access to justice and general improvement of the law.

The Law Council advises governments, courts and federal agencies on ways in which the law and the justice system can be improved for the benefit of the community. The Law Council also represents the Australian legal profession overseas, and maintains close relationships with legal professional bodies throughout the world.

The Law Council was established in 1933, and represents 16 Australian State and Territory law societies and bar associations and the Large Law Firm Group, which are known collectively as the Council's constituent bodies. The Law Council's constituent bodies are:

- Australian Capital Bar Association
- Australian Capital Territory Law Society
- Bar Association of Queensland Inc
- Law Institute of Victoria
- Law Society of New South Wales
- Law Society of South Australia
- Law Society of Tasmania
- Law Society Northern Territory
- Law Society of Western Australia
- New South Wales Bar Association
- Northern Territory Bar Association
- Queensland Law Society
- South Australian Bar Association
- Tasmanian Independent Bar
- The Large Law Firm Group (LLFG)
- The Victorian Bar Inc
- Western Australian Bar Association

Through this representation, the Law Council effectively acts on behalf of approximately 56,000 lawyers across Australia.

The Law Council is governed by a board of 17 Directors – one from each of the constituent bodies and six elected Executives. The Directors meet quarterly to set objectives, policy and priorities for the Law Council. Between the meetings of Directors, policies and governance responsibility for the Law Council is exercised by the elected Executive, led by the President who serves a 12 month term. The Council's six Executive are nominated and elected by the board of Directors. Members of the 2012 Executive are:

- Ms Catherine Gale, President
- Mr Joe Catanzariti, President-Elect
- Mr Michael Colbran QC, Treasurer
- Mr Duncan McConnel, Executive Member
- Ms Leanne Topfer, Executive Member
- Mr Stuart Westgarth, Executive Member

The Secretariat serves the Law Council nationally and is based in Canberra.