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Dear Sir

Limited Recourse Borrowings by Superannuation Funds (Instalment Warrants)

The MFAA thanks the government for the opportunity to comment on the proposed draft *Corporations Amendment Regulation – Limited Recourse Borrowings by Superannuation Funds (Instalment Warrants)*.

The MFAA is the peak national body providing service and representation to over 11000 professional credit advisers (mortgage and finance brokers, mortgage managers and aggregators) to assist them to develop, foster, and promote the mortgage and finance industry in Australia.

The MFAA shares the government's desire to ensure that superannuation funds (and self-managed superannuation funds (SMSFs) in particular) are adequately protected so that investments made in superannuation are available to superannuation fund members in their retirement. However, the MFAA considers it essential that any further regulation of the finance industry is appropriately directed to achieve its desired outcome.

To this end, although the Explanatory Memorandum to the proposed new Corporations Regulations contains some helpful statements as to the government's intent with these proposed regulations, the MFAA is concerned that the proposed regulations as currently drafted will not achieve their desired result - and may in fact have a detrimental effect on the ability of SMSFs to appropriately build wealth for their retirement through the use of limited recourse borrowing arrangements.

The MFAA's concerns with the proposed draft regulations are set out below.

Confusion between the role of finance brokers and the role of financial advisers

The MFAA's major concern with the proposed draft regulations is the lack of recognition that 'limited recourse borrowing arrangements' comprise two separate activities.

When an SMSF considers acquiring an asset under a 'limited recourse loan', the initial activity is the decision by the SMSF to acquire the asset using a limited recourse loan. This activity involves the provision of specialist advice to the SMSF about:

(a) whether the acquisition of a property by an SMSF is appropriate (given the SMSF's investment strategy),

and if so

(b) whether the SMSF should acquire the asset using a limited recourse loan or an instalment warrant arrangement.

Financial advisers and accountants with training and skills that meet the requirements of ASIC *Regulatory Guide 146 – Licensing: Training of financial product advisers* (**RG146**) are the appropriately qualified advisers to provide this advice. The MFAA notes that most major lenders in Australia require an SMSF entering into a 'limited recourse loan' to first obtain appropriate financial advice from a financial planner in an effort to ensure the entering into the arrangement is appropriate for the fund.

However, once the SMSF has received advice and made a decision that it wishes to acquire a property using a limited recourse loan, the SMSF must source the appropriate loan for their needs.

Finance brokers are experts in sourcing appropriate loans for clients. The recent introduction of the NCCP is intended to further increase the skills of finance brokers. Although loans to SMSFs are only regulated by the NCCP when the trustees of the SMSF are individuals and the loan purpose is to purchase a residential investment property, most of the finance brokers assisting SMSFs with obtaining a 'limited recourse loan' are regulated by the NCCP in other aspects of their business and bring their skills and experience to arranging these loans. Most brokers are MFAA members, and the MFAA also sets high standards for all loans, not just Credit Code regulated loans.

In contrast, financial advisers / accountants are often not experts in lending and as a result are poorly placed to provide advice to SMSFs on where to source an appropriate loan for their needs.

Most major finance brokers and aggregator groups make it clear that their brokers can only assist an SMSF to find a loan. The finance broker is specifically prevented from providing the SMSF with advice about the impact of investing in a particular property using a limited recourse loan (unless that finance broker holds an AFSL).

The MFAA is concerned that the draft regulations do not distinguish between the very different roles of financial advisers providing 'financial advice' to SMSFs (which is appropriately regulated under the Corporations Act) and the role of finance brokers assisting SMSFs to source a loan (which is clearly a credit activity). Although the Explanatory Memorandum seems to makes it clear that the government does not intend to regulate 'persons merely providing credit to SMSFs' (ie the regulations are not intended to regulate lenders), the proposed draft regulations do not make this clear and the role of finance brokers is completely overlooked by the regulations. This should be rectified.

Confusion caused by the focus of the proposed regulations on 'instalment warrants' rather than 'limited recourse loans'

Section 67A of the *Superannuation Industry (Supervision) Act* (**SIS Act**) was introduced in July 2010 and removed the concept of 'instalment warrants' from the SIS Act – replacing it with the more easily understood concept of a 'limited recourse borrowing arrangement'.

From the time section 67(4A) of the SIS Act (the predecessor to section 67A of the SIS Act) was introduced in September 2007, there was much confusion over what constituted an 'instalment warrant'. When most banks and major non-bank lenders began offering simple loan products which complied with the requirements of section 67A (and prior to that section 67(4A)) of the SIS Act, the MFAA welcomed the clarity these simple loans provided.

Given that the SIS Act no longer contains a reference to 'instalment warrants' and all major financiers in Australia do not offer structures which meet the legal definition of an 'instalment warrant', the MFAA is confused by the proposed draft regulations which focus on the 'instalment warrant structures'.

The Explanatory Memorandum to the proposed draft regulations states that under these 'instalment warrant structures' there is an '*up front payment to the issuer*'. This is not a feature of a 'limited recourse loan'. The structure of a 'limited recourse loan' is quite different.

- The Property Trustee purchases the property at the direction of the SMSF and becomes the legal owner.
- The SMSF is the beneficial owner of the property.
- The lender lends to the SMSF. Lender has no recourse against the assets of the SMSF other than the security property.
- The SMSF makes payments under the loan directly to the lender.
- The lender may require a guarantee and possibly collateral security from members of the SMSF. Collateral security cannot be taken from the SMSF itself.
- Loan funds must only be used for the purchase of a property and there can be no redraws or further advances.
- Once the loan is fully repaid, the SMSF may direct the Property Trustee to transfer the legal interest in the property to the SMSF.

The structure is represented diagrammatically in **Appendix A**.

As the proposed draft regulations have no application to a simple 'limited recourse loan structure', it has been suggested to the MFAA that the proposed draft regulations will only apply to true 'instalment warrant structures'. Unfortunately, the proposed draft regulations do not make this clear. The proposed draft regulations must be amended to make this clear in order to avoid confusion and uncertainty in the industry.

Concerns over the impact of further regulation in the financial services and credit industries

The financial services and credit industries are already struggling to keep up with the vast amounts of recent regulatory changes – from the recent introduction of the *National Consumer Credit Protection Act* and *National Credit Code* to the imminent introduction of the *Future of Financial Advice Reforms*. While the MFAA understands the government's desire to provide a legislative framework that will protect consumers, the MFAA urges the government to give the recent changes time to have an impact before introducing further changes.

The MFAA considers that any further legislative changes imposed on finance brokers and financial advisers / accountants run a real risk of 'missing the mark' as the impact of changes already made and proposed will not have yet had any effect.

The industry is already struggling to keep up with the myriad of changes to legislation in the financial services sector and that additional changes are likely to actually result in a contraction of the industry as the cost of compliance outweighs the benefits of doing

business. As such, the MFAA is concerned that Australian consumers may actually find it more difficult to obtain appropriate professional advice on either their lending requirements or their investment and risk management strategies.

Further, regulations such as the proposed regulations may result in significant numbers of people currently making these 'limited recourse loans' available to SMSFs actually reducing their product offering or in some cases leaving this part of the industry altogether.

With strict caps on contributions imposed on SMSFs, the removal of the ability for SMSFs to create wealth by appropriate gearing is likely to result in more people relying on government pensions in old age or people being forced to remain in the workforce for longer (resulting in higher unemployment for younger people) as investments in superannuation fail to generate the income required by members in their retirement.

The MFAA encourages the government to refrain from making further changes to the financial services laws at least until industry has had the opportunity to observe the results of the changes that have already been made or that are close to implementation.

Conclusion

As a pre-eminent industry body, active in the credit industry, the MFAA would welcome the opportunity to meet with Treasury to discuss this proposed legislation further.

The MFAA is also willing to work with Treasury to ascertain whether additional legislation would be beneficial in this area, (and if so, how it should be drafted). The MFAA has extensive experience in this type of work, having recently worked closely with Treasury to draft the NCCP.

Yours sincerely

PHIL NAYLOR
CHIEF EXECUTIVE OFFICER

Appendix A