

SUBMISSION

25 June 2010

“Proposed changes to the Corporations Regulations
for superannuation borrowing arrangements”

TO:

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Self-Managed Super Fund Professionals'
Association of Australia Limited
(‘SPAA’)

Proposed changes to the Corporations Regulations for superannuation borrowing arrangements

Purpose of Submission

SPAA welcomes the opportunity to make a submission on the proposed amendments to the Corporations Act 2001 (Corporations Act) and Regulations which were announced by the Hon. Chris Bowen, Minister for Financial Services, Superannuation and Corporate Law on 10 March 2010.

SPAA has made a number of submissions to Government and Regulators regarding borrowing arrangements for superannuation funds, and in particular SMSFs. With suitable assets and gearing levels, and issuing suitable investment and security structures, SPAA believes that limited recourse complying loan structures can provide benefits which are not otherwise available to superannuation funds.

About SPAA

1. SPAA is the peak professional body representing the self managed superannuation fund (SMSF) sector throughout Australia. SPAA represents professionals, irrespective of their personal membership and professional affiliations, who provide advice to individuals aspiring to higher levels of participation in the management of their superannuation savings. Membership of SPAA is principally accountants, auditors, lawyers, financial planners and other professionals such as actuaries.
2. SPAA is committed to raising the standard of professional advice and conduct in the SMSF sector by working proactively with Government and the industry. In doing so, SPAA has contributed to SMSF advisors providing a higher standard of advice to SMSF trustees. This in turn has enabled trustees to make more informed decisions addressing the adequacy, sustainability and longevity of their own retirement savings. SMSFs offer trustees greater control and flexibility and have become an integral part of the Australian Superannuation landscape by providing significant and viable options for managers, business owners, executives and retail operators alike.

Summary of SPAA recommendations

3. **Recommendation No.1 – Financial product** -That the component of a borrowing arrangements for purposes of section 67(4A) of the Superannuation Industry (Supervision) Act 1993 which consists of the bare trust and the underlying investment as issued or arranged should be declared to be a financial product for purposes of the Corporations Regulations 2001.
4. **Recommendation No.2 – Credit facility** - That the component of the borrowing arrangements for purposes of section 67(4A) of the Superannuation Industry (Supervision) Act 1993 not be treated as a credit facility.

5. **Recommendation No.3 – Derivatives** - That the component of the borrowing arrangements for purposes of section 67(4A) of the Superannuation Industry (Supervision) Act 1993 which consists of the bare trust and the underlying investment as issued or arranged should not be a derivative as defined in the Corporations Act 2001 and Regulations.

Submission

SPAA recognises that the primary purpose of the introduction of section 67(4A) into the SIS Act has been to legitimise investments by superannuation fund trustees in traditional instalment warrants that include underlying borrowings. The terms of section 67(4A), and its proposed successors are designed to cover traditional and non-traditional instalment warrants. Traditional instalment warrants are those instruments where the value is ascribed from an identified asset and can be traded on a market that is independent of that asset. In contrast, non-traditional borrowing arrangements as envisaged by section 67(4A) do not consist of an instrument which is tradable and do not relate to a separate asset.

SPAA considers that because of the consumer protection aspects of borrowing arrangements as defined in Section 67(4A) of the Superannuation Industry (Supervision) Act 1993 (SIS Act) only a person who is licensed and competent to provide financial advice in terms of the Corporations Act should be authorised to advise on whether a borrowing arrangement under s67(4A) of the SIS Act is appropriate for the relevant superannuation fund. It is considered that under the current rules a financial planner who meets the requirements of RG146 in superannuation and meets any additional requirements of their licensee in relation to the provision of self managed superannuation fund advice is adequately qualified to provide advice in this regard. It should be noted that SPAA has made a number of recommendations to the Cooper review on possible changes to competencies in relation to the provision of advice by those who advise on self-managed superannuation funds.

SPAA agrees with the amendments to the Corporations Regulations by the insertion of sub regulation 7.1.06(2A) that arrangements defined in section 67(4A) of the SIS Act do not constitute a credit facility. It is considered that the definition of the 'financial product' should be limited to the investment which is held under the bare trust arrangement and its relevance to the overall investment strategy of the superannuation fund. The financial product could also include the trust structure in which the particular asset is held.

SPAA does not agree that the requirement to treat the bare trust and the underlying investment for purposes of section 67(4A) as a derivative is appropriate or correct. The general understanding of a derivative arrangement is that the value of the derivative is obtained from or by reference to the value of another asset. For example, in the case of derivatives such as options over shares or those relating to traditional instalment warrants, - the value is obtained from that of the underlying share. In the case of the borrowing arrangements under section 67(4A) there is no interposed entitlement which is based on the asset that is held by the bare trust. The value of the asset that has been financed from the superannuation fund borrowing is used to determine what entitlement to the asset the fund actually has a right to. The value to the fund of the asset is not determined from the value of a financial arrangement such as an option or traditional instalment warrant.

As an example, if we assume a superannuation fund has borrowed for purposes of purchasing real estate then the net value of the real estate to the superannuation fund will be the market value of the property less the value of any outstanding loan from time to time. As the net value of the particular asset subject to the borrowing arrangement is accounted for in the fund it could not be considered to be in the nature of a derivative. The same would also apply with other assets that are subject to borrowing arrangements where the value of the asset as accounted for in the superannuation fund is its market value less any outstanding borrowing. There are a number of ways in which the net value of the asset can be determined, however, the value of the asset to the superannuation fund is not determined by an interposed instrument such as an option or traditional instalment warrant the value of which is obtained from an underlying asset.

The manner in which the value of the asset is determined in the superannuation fund is also confirmed by the requirement that it be held to satisfy the provisions of section 67(4A). The ATO indicate that the most appropriate manner in which the asset is held is as a bare trust. Where a bare trust is declared over a particular asset the trustee of that bare trust merely holds the asset and does nothing more with it until directed in terms of the trust. Under the borrowing arrangements in section 67(4A) it is the superannuation fund as beneficiary who is able to instruct the trustee to act in a particular way which will allow the particular asset to be disposed of, transferred or replaced. Therefore the control the superannuation fund is able to

exercise in relation to the asset which is held in the bare trust arrangement, and the manner in which the value is accounted for in the fund, is not consistent with a derivative such as an option.

Another aspect of traditional instalment warrants is that an initial payment is made for the investment and the second payment is optional, that is, the purchaser of the warrant can elect to forfeit the warrant by not making a second payment without incurring any further liability. While this has similarities with the non-recourse borrowing arrangements of s67(4A), SPAA believes that the policy reasons behind the requirement in s67(4A) set these arrangements apart from traditional instalment warrants. This is because the non-recourse nature of the borrowing for the purposes of s67(4A) is to provide protection to the other superannuation fund assets not the subject of the borrowing arrangement. It is not usually a feature of the borrowing arrangement entered into under a s67(4A) arrangement or an expectation either by the lender or the superannuation fund that the superannuation fund can and will default on the amount borrowed at their discretion, should the superannuation fund decide for any reason that the investment is not appropriate. The recourse to the asset is seen as a remedy of last resort for the lender rather than a feature of a product.

The last point above also highlights another difference between traditional instalment warrants and s67(4A) arrangements. This is, that traditional instalment warrants have the borrowing built into or imbedded in the product being purchased by the superannuation fund. With s67(4A) arrangements, the structure (being the bare trust arrangement to hold the assets being the subject of the borrowing arrangement) is separate and distinct from the borrowing. Even where the advice and amount borrowed by the institution also providing the loan facility, it is SPAA's view that the advice in relation to the implementation of the s67(4A) arrangement is distinct from the borrowing.

Further Information

We would be pleased to provide you with any further information in support of our submission.

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