



Superannuation Industry (Supervision) Amendment Bill 2010

Leslie Nielson
Economics Section

Contents

Purpose.....	2
Background	2
What is an instalment warrant?	2
Extent of SMSF investment in instalment warrants	3
SMSF investment in instalment warrants as non-recourse loans	3
Why undertake non-recourse loans?	4
Interaction with other recent policy developments	5
Basis of policy commitment	5
Committee consideration	5
Position of significant interest groups/press commentary	6
Pros and cons	6
Financial implications	6
Main provisions	6

Superannuation Industry (Supervision) Amendment Bill 2010

Date introduced: 26 May 2010

House: House of Representatives

Portfolio: Treasury

Commencement: The day after Royal Assent

Links: The [links](#) to the Bill, its Explanatory Memorandum and second reading speech can be found on the Bills page, which is at <http://www.aph.gov.au/bills/>. When Bills have been passed they can be found at ComLaw, which is at <http://www.comlaw.gov.au/>.

Purpose

This Bill amends the *Superannuation Industry (Supervision) Act 1993* (SIS Act) to:

- reduce the risks to superannuation funds undertaking limited recourse borrowing, and
- resolve some uncertainty about the application of the current exemption from the general ban of a superannuation fund borrowing funds to invest.

Background

Section 67 of the SIS Act generally prevents a trustee of a regulated superannuation fund from either:

- borrowing money, or
- maintaining an existing borrowing of money.

There are particular exceptions to this general rule, mostly to cover a temporary need for liquid funds to settle outstanding securities transactions or to pay the Superannuation Surcharge (now repealed).

That said, subsection 67(4A) permits a trustee to purchase instalment warrants. This subsection was inserted into the SIS Act in 2007.¹ It is the consequences of this amendment that has led to this particular Bill coming before Parliament.

What is an instalment warrant?

At the time subsection 67(4A) was inserted into the SIS Act in 2007, an instalment warrant was understood to be:

1. Subsection 67(4A) was inserted into the SIS Act by Section 1 of Schedule 3 to the *Tax Laws Amendment (2007 Measures No. 4) Act 2007* (No. 143, 2007).

Warning:

This Digest was prepared for debate. It reflects the legislation as introduced and does not canvass subsequent amendments.

This Digest does not have any official legal status. Other sources should be consulted to determine the subsequent official status of the Bill.

a derivative-based investment product, in that they derive their value from the underlying asset. Traditionally, such arrangements provide the investor with the right, but not the obligation, to buy the underlying asset through the payment of instalments. Investors in instalment warrants have a beneficial interest in the underlying asset, subject to a security interest held by the issuer that secures the payment of later instalments. Once the investor has made the first instalment they are likely to be entitled to income from the underlying asset (e.g. dividends from shares).²

These arrangements involved loaning the investor (in this case a superannuation fund) money to purchase the underlying asset (usually shares but also now property). Generally the loan is repaid from the dividend or rent receipts, as the case may be. The Commissioner for Taxation and the Australian Prudential Regulation Authority (APRA) had previously identified these products as a prohibited borrowing under section 67 of the SIS Act. These products had been marketed to superannuation funds, particularly self-managed superannuation funds (SMSF).³ They are, in effect, a form of negatively geared investment.

Extent of SMSF investment in instalment warrants

Recent research carried out by the current Review of the Governance, Efficiency, Structure and Operation of Australia's Superannuation System (that is, the Cooper Review) notes that:

Initial interest in instalment warrants was modest, with only 0.9 per cent of the SMSF population having a derivative or instalment warrant at 30 June 2008. There are, however, indications that this trend might have changed in recent times. Data from Investment Trends' surveys suggest that more than five per cent of SMSFs already invest in such instruments.⁴

SMSF investment in instalment warrants as non-recourse loans

In allowing superannuation funds to invest in these products, the 2007 amendment to the SIS Act specified that the lender must only have recourse to the underlying assets of the

-
2. Explanatory Memorandum to Tax Laws Amendment (2007 Measures No. 4) Bill 2007, Taxation (Trustee Beneficiary Non-Disclosure Tax) Bill (No. 1) 2007, Taxation (Trustee Beneficiary Non-Disclosure Tax) Bill (No. 2) 2007, p. 122, viewed 26 May 2007, [http://www.comlaw.gov.au/ComLaw/Legislation/Bills1.nsf/0/0409F646F8EA53D2CA257306000CF903/\\$file/07136em.pdf](http://www.comlaw.gov.au/ComLaw/Legislation/Bills1.nsf/0/0409F646F8EA53D2CA257306000CF903/$file/07136em.pdf)
 3. Ibid.
 4. Australian Government, *Self-Managed Super Solutions, a Preliminary Report of the Review of the Governance, Efficiency, Structure and Operation of Australia's Superannuation System*, Canberra, 29 April 2010, p. 28, viewed 27 May 2010, http://www.supersystemreview.gov.au/content/downloads/self_managed_solutions/self_managed_super_solutions.pdf

Warning:

This Digest was prepared for debate. It reflects the legislation as introduced and does not canvass subsequent amendments.

This Digest does not have any official legal status. Other sources should be consulted to determine the subsequent official status of the Bill.

warrant, and to no other asset of the investor's superannuation fund. However, lending practices arose that circumvented this particular requirement, such as:

- the use of personal guarantees, given by the superannuation fund trustee to the lender, to underwrite the latter's risk in this borrowing arrangement (this appears to occur where the underlying asset of the instalment warrant is property, rather than a listed investment)⁵
- borrowing arrangements over multiple assets which may allow the lender to choose which assets are sold in the event of a loan default, or
- arrangements where the asset(s) subject to the borrowing may be replaced at the discretion of the trustee, or the lender.⁶

These developments reduce the security of a superannuation fund's investments by reducing the control a superannuation fund trustee has over their investments and potentially allowing the borrowing to be secured against a wider range of assets of the fund, as well as assets outside the fund. This is not the intent of section 67 of the SIS Act.

Why undertake non-recourse loans?

Recent developments in government policy on superannuation contributions have led to increased use of borrowed funds by SMSFs. From 1 July 2009 annual contributions to superannuation funds, by or on the behalf of, an individual could not exceed:

- \$150 000 in after tax contributions (or \$450 000 over a three year period),⁷ and
- \$25 000 in tax deductible contributions (such as Superannuation Guarantee contributions) (or for a limited period \$50 000 if contributor is over 50 years of age).⁸

In the recent Budget the Rudd government proposed a slight relaxation of these limits.⁹

It is argued that these limits restricted a person's ability to build up substantial superannuation concessions, especially in later working years. Superannuation fund

-
5. A Sampson, 'An accident waiting to happen', *Sydney Morning Herald*, 13 March 2010, p. 5, viewed 27 May 2010, http://parlinfo.aph.gov.au/parlInfo/download/media/pressclp/Z85W6/upload_binary/z85w60.pdf;fileType=application/pdf#search=%22non-recourse%20loans%22
 6. Explanatory Memorandum, Superannuation Industry (Supervision) Amendment Bill 2010 (hereafter Explanatory Memorandum), pp. 3-4.
 7. *Income Tax Assessment Act 1997* (ITAA 1997) subsection 290-85(2).
 8. ITAA 1997, section 292-20.
 9. Australian Government, *Budget measures: budget paper no. 2: 2010-11*, Commonwealth of Australia, Canberra, 2010, p. 41, viewed 12 May 2010, <http://www.aph.gov.au/Budget/2010-11/content/bp2/download/bp2.pdf>

Warning:

This Digest was prepared for debate. It reflects the legislation as introduced and does not canvass subsequent amendments.

This Digest does not have any official legal status. Other sources should be consulted to determine the subsequent official status of the Bill.

members therefore have a higher incentive to undertake negative gearing investment strategies permitted by the provisions of section 67 of the SIS Act in order to rapidly increase the level of their superannuation benefits.¹⁰

Of course, the concessional tax environment inside a superannuation fund makes it attractive to undertake negatively geared investments. This is of particular relevance to an SMSF in relation to residential property, as individual investors usually invest in this particular asset class and such funds are the domain of individual investors.¹¹

Interaction with other recent policy developments

The proposed amendments are related to the recently announced alteration of the Corporations Regulations 2001 to classify certain borrowing arrangements permitted under the SIS Act as ‘financial products’. When these regulations are altered instalment warrants marketed to superannuation funds will be subject to the consumer protection provisions of the Corporations legislation. Amongst other things this means that these warrants can only be offered to superannuation funds by licensed financial service providers.¹²

Basis of policy commitment

The proposed measures were first announced upon this Bill’s introduction into Parliament on 26 May 2010.¹³

Committee consideration

The Bill has been referred to the Senate Standing Committee on Economics for inquiry and report by 15 June 2010. Details of the inquiry are at http://www.aph.gov.au/Senate/committee/economics_ctte/index.htm

-
10. B Brown, ‘Why to use super to buy property’, *Australian Financial Review*, 16 January 2010, Smart Money Section, p. 1 and following, viewed 27 May 2010, http://parlinfo.aph.gov.au/parlInfo/download/media/pressclp/4LNV6/upload_binary/4Inv60.pdf;fileType=application/pdf#search=%22non-recourse%20loans%22.
 11. Ibid. Briefly, an SMSF may have no more than four members, all of whom must be trustees of the fund. Generally SMSFs have only two members. As such, they are ideal vehicles for undertaking personal investment strategies inside a tax advantaged environment.
 12. C Bowen (Minister for Financial Services, Superannuation & Corporate Law & Minister for Human Services), *Financial services consumer protection framework extended to superannuation borrowing arrangements*, media release, Canberra, 10 March 2010, viewed 27 May 2010, <http://mfsscl.treasurer.gov.au/DisplayDocs.aspx?doc=pressreleases/2010/020.htm&pageID=003&min=ceba&Year=&DocType=0>
 13. Explanatory Memorandum, p. 1.

Warning:

This Digest was prepared for debate. It reflects the legislation as introduced and does not canvass subsequent amendments.

This Digest does not have any official legal status. Other sources should be consulted to determine the subsequent official status of the Bill.

Position of significant interest groups/press commentary

To date, what press commentary has occurred on the use by superannuation of non-recourse loans has identified the need for tighter regulation in this area.¹⁴

Pros and cons

The proposed changes will increase a superannuation fund trustee's control over the assets of the fund and prevent security being taken over superannuation fund assets that were not purchased with borrowed money.

That said, these changes only apply to arrangements entered into after these provisions take effect, that is on the day after the date of Royal Assent. Existing non-recourse arrangements will continue to be exposed to the problems noted above.

Financial implications

The Explanatory Memorandum to this Bill notes that its provisions do not have any financial impact.¹⁵

Main provisions

Item 7 of Schedule 1 to the Bill repeals existing subsection 67(4A) SIS Act, which contains the current provisions governing a superannuation fund's investment via limited-recourse loans (instalment warrants).

Item 8 inserts **new section 67A** into the SIS Act setting out the conditions under which the trustee of a superannuation fund may undertake and maintain a limited-recourse loan. Briefly, these proposed new conditions are:

- the loan is only for the purposes for acquiring a single acquirable asset (see proposed definition of *acquirable asset* below)
- the acquirable asset is held on trust for the superannuation trustee
- the superannuation trustee has a right to acquire legal ownership for the acquirable asset by making one or more repayments after acquisition, and
- the lender's rights are only secured against the relevant acquirable asset.

Effectively, **proposed section 67A** prevents a lender taking a charge over multiple assets of the superannuation fund when making a limited-recourse loan. Further, the lender's security can only be held against the acquirable asset. A personal guarantee granted by the

14. A Sampson, op, cit.

15. Explanatory Memorandum, p. 1.

Warning:

This Digest was prepared for debate. It reflects the legislation as introduced and does not canvass subsequent amendments.

This Digest does not have any official legal status. Other sources should be consulted to determine the subsequent official status of the Bill.

superannuation fund trustee will not be effective in securing the lender's interest in that asset.

Proposed subsections 67A(2) and (3) define what an *acquirable asset* is. Briefly, such assets:

- are assets that are not money (whether Australian or any other currency)
- assets that are legally able to be acquired by the superannuation trustee, and
- may be a collection of separate items, provided that each item has the same market value and these items are identical to each other.¹⁶

Item 8 also inserts **new section 67B** into the SIS Act. Effectively, this new section defines the situations where an asset can be replaced, and still fall under the provisions of **new section 67A**. Briefly, these situations are where shares in a company or units in a unit trust are replaced with new shares or units, as the case may be, at equal market value.

Real estate is specifically excluded from this new section. This means that the superannuation fund trustee cannot be forced to replace one property with another by the lender.

Item 14 states that the amendments in **Schedule 1** apply to arrangements entered into on or after the day after Royal Assent. Thus, these provisions are not retrospective.

16. The Bill gives the example of a collection of shares in the same company as being a collection of assets that satisfy this criterion.

Warning:

This Digest was prepared for debate. It reflects the legislation as introduced and does not canvass subsequent amendments.

This Digest does not have any official legal status. Other sources should be consulted to determine the subsequent official status of the Bill.

© Copyright Commonwealth of Australia

This work is copyright. Except to the extent of uses permitted by the *Copyright Act 1968*, no person may reproduce or transmit any part of this work by any process without the prior written consent of the Parliamentary Librarian. This requirement does not apply to members of the Parliament of Australia acting in the course of their official duties.

This work has been prepared to support the work of the Australian Parliament using information available at the time of production. The views expressed do not reflect an official position of the Parliamentary Library, nor do they constitute professional legal opinion.

Feedback is welcome and may be provided to: web.library@aph.gov.au. Any concerns or complaints should be directed to the Parliamentary Librarian. Parliamentary Library staff are available to discuss the contents of publications with Senators and Members and their staff. To access this service, clients may contact the author or the Library's Central Entry Point for referral.

Members, Senators and Parliamentary staff can obtain further information from the Parliamentary Library on (02) 6277 2495.

Warning:

This Digest was prepared for debate. It reflects the legislation as introduced and does not canvass subsequent amendments.

This Digest does not have any official legal status. Other sources should be consulted to determine the subsequent official status of the Bill.