

INVESTMENT MANAGEMENT MANNA FROM GOVERNMENT SUPER HEAVEN

Are you still counting your business profits from the greatest superannuation influx this country has ever seen? Has your office administration finally settled down? Have you just returned from or are you planning your next holiday?

If you have said yes to any of these questions, you are likely to miss out on the next greatest superannuation investment opportunity; superannuation funds can now borrow to invest! The billions that have recently been pumped into superannuation can now be geared; the investment mass of superannuation can be potentially doubled or even more.

The detail of the new borrowing law is found in section 67(4A) of the Superannuation Industry (Supervision) Act, 1993. This now provides an exception to the superannuation borrowing restriction. In simple terms, a superannuation fund trustee can now borrow to acquire a beneficial interest in an asset that is held on trust. The law is not exactly clear what type of trust that it must be but it must enable an instalment type process for the superannuation fund acquisition of the asset. The fund must enjoy a right (but not an obligation) to acquire the legal ownership of the asset (or any replacement) through the payment of instalments. On the other hand, the lender's recourse in the event of a default on the borrowing (and related fees) is limited to rights relating to the asset at the time of the action, such as taking possession of, or disposing of, the asset.

The new section 67(4A) is called Exception – Instalment Warrants giving the impression that this new exception to the borrowing restriction is somehow limited to the financial product that many are familiar with – Instalment Warrants. This is not correct, there is no limit of the borrowing principles to an investment format that looks or feels like an instalment warrant. What is required is a set of legal relationships that creates a Debt Instalment Trust (DIT) that enables a superannuation fund to acquire an asset.

Of significance to many is that the asset may be any asset (eg, real property, works of art or listed securities) that a fund may invest in directly. The existing investment restrictions such as investing for a sole retirement purpose, or against an in-house asset or acquiring assets from a related party of the fund, continue to apply to the DIT arrangement.

Let's look at the highlights:

1. It is now LAW. You can gear superannuation now.
2. The borrowing can be for investments in any assets; shares, property and even works of art.
3. Currently held assets cannot be geared, it is limited to newly acquired assets.
4. You can swap underlying geared assets.
5. The arrangement can only be achieved through the use of a DIT structure.

6. The lender's security is limited to the asset, as far as the superannuation fund is concerned.

The planning opportunities are almost limitless, many self managed superannuation fund trustees that were once frustrated from achieving their investment ideals through a lack of funds, can now borrow to make that real estate purchase or enhance their share portfolio.

It is curious that there is no limitation on who the lender may be, conceivably the superannuation fund member could be the lender to his or her own superannuation fund. Thus, a member may be able to get much more of their wealth working for them in their superannuation fund, more than the recent superannuation contribution caps allow, the excess will just be a borrowing that will enable the income and capital gains to be earned in a concessional tax environment.

Whilst many lenders may not want to lend to a DIT under a non-recourse arrangement, there is no prohibition on the member providing personal guarantees or personal security to 'fill the lender's security gap'. The new legal requirement is only that the rights of the lender against the RSF trustee for default on the borrowing must be limited to the underlying asset. No where does the new law make it clear that this can be the only security that the lender takes. The lending documents can provide no recourse to the superannuation trustee beyond the asset interest, but at the same time it can allow recourse to the member in their personal capacity.

When structuring a DIT there are a few tips and tricks to watch out for:

1. all of the usual superannuation investment rules must be followed. The two most important of these are the sole purpose test and the arms length test, especially where the member is the limited recourse lender or has guaranteed to make up any shortfall;
2. use of a trust structure can be quite problematic. Care is needed to avoid a potential double stamp duty on the first purchase of the asset by the DIT and the second purchase of it under the instalment arrangement;
3. dissolution of the DIT on final payment of the instalment can give rise to capital gains tax concerns.

In view of the proposed borrowing structure that is to be allowed, it is important to get the structure right at first instance. It will be too expensive to rewrite the primary rules.

Whilst I welcome the commercial opportunities for both my own superannuation fund and my business which has been working in this market for some time, I do find the requirement for any arrangement to involve a DIT to be asinine. It demonstrates that whoever instructed the legislative draftsmen did not understand what they were doing or that the draftsmen sought to narrow the new law, but did so in an expansive sort of way. Why do I say that it is asinine in its structure? The economic effect of the DIT is that the superannuation fund has borrowed and secured the borrowing against one of its asset. The only difference between a standard loan and the DIT arrangement is that the lender does not have recourse to any other assets of the superannuation fund.

So instead of simplicity, we have complexity but in a simple sort of DIT way!

Who do you have to thank? Instalment warrant issuers and stakeholders in the instalment warrant market have worked behind the political scenes to achieve the new DIT laws, however, I am certain that even they did not believe the new exception would be cast in as broad a language as we now have.

This legislative change in thinking also demonstrates the benefits of a mass breach of the law; provided that it is in a conservative and purposeful manner. The explanatory memorandum recognises that over a number of years, instalment warrants have been marketed to superannuation funds, particularly self-managed superannuation funds. Further, it recognises that both the Australian Taxation Office and the Australian Prudential Regulatory Authority have expressed the view that instalment warrants do not work. (Incidentally, in my view they were wrong. A properly structured instalment warrant was always available under the SIS). So the new law 'corrects' the Regulators thinking about the very many superannuation funds that were in breach of the law by making it legal!

Perhaps another way of looking at this is to say that as long as the financial product industry agrees to cooperatively breach the law (at least in view of the Regulators), eventually the Government will amend the law to enshrine the breach.

This is the same mass breach thinking that gave birth to the original allocated pension concept that also became sanctioned by the Government.

If you have just finished helping the superannuation fund trustee complete their investment strategy following the influx of million dollar non-concessional contributions, it is time to re-visit the strategy yet again – it is DIT Time!

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