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MORE FUNDS BORROW

DIY lobby group takes on 'rogues'

The SMSF Professionals Association is trying to protect trustees from debt-funded super strategies, writes **Neale Prior**

The peak lobby group for self-managed superannuation fund advisers has moved to reduce regulator anxiety about the aggressive promotion of debt-funded investment strategies.

The SMSF Professionals' Association has published guidelines for advisers and banks dealing with DIY trustees considering borrowing money through their super funds to buy property, shares or other investments.

The guidelines come amid warnings from regulators and consumer groups about the property spruikers and investment advisers persuading trustees to borrow money under so-called limited recourse borrowing arrangements.

SMSF Professionals Association chief executive Andrea Slattery said only a "tiny rogue minority" had been spruiking LRBAs but there was a need to create best-practice guidelines.

Estimating the major banks had about 85 per cent of the LRBA market, Ms Slattery said National Australia Bank had signed onto the guidelines and other major lenders were "in the pipeline".

Borrowing to bankroll the expansion of funds can be seen as a useful strategy for skilled investors; LRBA arrangements are being pushed by promoters to inexperienced investors to buy properties arguably too big when compared with the trustee's nest egg.

West Perth financial planner Marijana Ravlich, a SMSF specialist, said she was concerned about property promoters persuading people with small nest eggs to borrow money through a SMSF and buy off the plan.

The Life Financial Planners director said a gearing strategy might work for someone who already had a significant, balanced investment portfolio in their SMSF or had members on a high income able to promptly repay a loan.

The arrangements can expose people closely involved with an SMSF to potential guarantee or indemnity claims from the financier in the event the deal goes sour.

Under LRBA arrangements, the financier's ability to claw the loan back from the DIY fund trustee is limited to the asset that is subject to the arrangement. However, the financier can ask for a third-party guarantee before entering the loan arrangement.

A financier might lend only about 50 per cent of a residential property under a standard LRBA but may agree to increase this to 80 per cent where a third party guarantee or indemnity is provided.

The Financial Systems Inquiry report released last month warned that the number of super funds borrowing had risen about 11 per cent to 380,000 in the year to April.

MATTERS AN ADVISER MUST COVER

- Is a borrowing strategy appropriate?
- The risks of large or lumpy assets
- Risks of investing in a single asset within a fund
- Appropriate diversification and being overweight in a single asset class
- Investment time frames
- Risks of limited recourse borrowing arrangements
- The risk of LRBAs with direct investment in property
  - Increased investment risks associated with leverage
  - Loan servicing and cash flow risks
  - Interest rate risk
  - Investment and rental income risks

Source: SMSF Professionals Association

Marijana Ravlich

The David Murray-led inquiry team also pointed to work by the Australian Securities and Investments Commission showing much of the poor advice on setting up SMSFs was linked to funds with gearing strategies.

Suggesting consideration be given to stopping funds entering LRBAs, the inquiry report warned the borrowing might create vulnerabilities in the super system if it were allowed to continue.

Some residential property investment companies are pushing LRBAs.

The SMSF Professionals Association has opposed a ban on super fund LRBAs, saying more than 80 per cent of loans were to buy commercial properties. It blamed risky lending on unscrupulous advisers.

Releasing the voluntary industry guidelines, Ms Slattery said the Federal Government and regulators could have confidence that LRBAs were being used appropriately given NAB had signed on and the other lenders were not far away.

The association published separate guidelines for financiers and advisers, designed to encourage self regulation.

She was confident that "adherence to the guidelines by the banking and financial advice industry will ensure that LRBAs are being used appropriately by SMSF trustees".

Yet under the guidelines for financiers, the banks will not have to make a potential borrower get advice from an adviser complying with the guidelines or even obtain advice along the lines of what is contained in the guidelines for advisers.

The banks be required to recommend to a potential SMSF borrower that they use an appropriate specialist SMSF, financial

SMSF group forced to act — the writing

Neale Prior
Personal Finance Editor

Faced with David Murray's Financial Systems Inquiry mooting restrictions on borrowing by superannuation funds, the SMSF Professionals Association had to do something.

The association likes to blame the proliferation of dodgy gearing strategies on cowboy advisers and promoters preying on people who do not properly understand the risks of debt-driven investment.

It is true that there are property spruikers trying to get their greasy mitts into Australia's $1.8 trillion super nest egg by encouraging people to set up DIY super funds, borrow and invest in property.

It is also true that people are being told to do this by accountants and financial advisers who know better.

These people have a vested interest in getting people out of public offer super funds and into DIY funds.

There are all sorts of auditing, accounting and advisory fees that they would not receive if the client stuck with their industry or public offer superannuation fund.

There are inherent problems with guidelines or any self-regulation that relies on trusting industry players to do the right thing. Self-regulation clearly failed in the recent scandals surrounding Commonwealth Bank's financial planning arms and the notoriously flat-footed regulators at the Australian Securities and Investments Commission.

Guidelines can be useful for ethical and skilled operators who might need a reminder or even a checklist to make sure they are doing the right thing by the client.

However, such guidelines are next to useless with people who put their commercial advantage above that of the client.

The disincentives for these people are only as good as the regulation of their industry, including potential disciplinary action by professional bodies.

While an accountant or financial planner is breaching professional standards when they brazenly put their commercial considerations over their duty to their clients, banks have few such obligations.

Yet the standards published by the SMSF Professionals Association place far less obligation on banks than they do on advisers.

It does not place any obligation on the bank to ensure the SMSF trustee borrowing money on behalf of their super fund has received independent professional advice.

Under the guidelines, the banks must give the trustee information about the advantages and risks of a limited recourse borrowing arrangement and let them know what happens if things go wrong.

The banks have to recommend the client use an "appropriate specialist SMSF, financial or legal adviser" for advice and information.

And to give the banks the perfect out clause, they must seek an acknowledgment from the trustee that this recommendation to get advice has been given. The trustee must also acknowledge the fund is compliant with Superannuation Industry (Supervision) Act rules.

All these guidelines do is provide cover for the bank. The bank's role is to legally make as much money as securely as possible for its shareholders.

It does nothing to stop a situation where a one-stop shop SMSF property spruiker gives their customers a blueprint for a SMSF, has a suite of properties