



10 July 2007

Committee Secretary  
Senate Economics Committee  
Department of the Senate  
Parliament House  
Canberra  
ACT 2600

Dear Sir or Madam

### **Tax Laws Amendment (2007 Measures No. 4) Bill 2007 – Schedule 3**

The Australian Financial Markets Association (AFMA) represents over 130 participants in the Australian wholesale banking and financial markets in respect of regulation and other matters that impact their business. AFMA's membership includes the major issuers of instalment warrants who welcome the introduction of the provisions in Schedule 3 of the Bill because it substantively offers clarity and certainty for the market going forward. We recommend a minor addition to the provisions which, though modest in form, would enhance the market.

#### **1. Background & Proposed Changes**

Instalment warrants are instruments that provide investors with an exposure to a reference asset through an initial part payment followed by a final payment at a later date. The final payment is typically structured as a limited recourse loan. Instalment warrant holders are entitled to the income stream (dividends and franking credits) from the underlying share or asset. Interest on the loan amount is typically prepaid annually for the life of the instalment warrant.

Instalment warrants are designed for the retail market and, thus, offer significant safeguards to investors. AFMA believes the limited recourse feature of instalment warrants is the threshold factor to be considered for eligibility as an investment for superannuation funds. In this regard, instalment warrants are arguably less risky than instalment receipts used, for example, to sell off the Government's interest in Telstra.

Instalment warrants offer important benefits to investors including:

- Leveraged investment exposure to the movement of the underlying asset's capital value;
- Entitlement to income from the underlying asset;
- The investor is entitled to tax benefits from deductions and franking credits;
- Capital protection for the amount of the loan because the completion payment for the underlying asset is not compulsory.

The provisions in Schedule 3 provide an exception to the borrowing restriction in section 67 of the Superannuation industry (Supervision) Act 1993, which will allow superannuation funds to invest in instalment warrants of a limited recourse nature over any asset a fund would be permitted to invest in directly. The amendment is necessary to address the consequence of the Australian Taxation Office and the Australian Prudential Regulation Authority coming to the view that instalment warrants are a borrowing for section 67 purposes. AFMA believes the amendment is required to provide certainty for the market going forward.

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AFMA also supports the amendment to the in-house asset rules contained in the Act to provide that an investment in a relevant related trust will only be an in-house asset where the underlying asset would be an in-house asset of the fund were it held directly.

## 2. Suggested Refinement - Equalisation of Exceptions to In-House Assets

While we support the measures contained in Schedule 3, we would like to recommend an additional amendment that we believe would improve the operation of the law.

The proposed legislation, by adding clauses 8 and 9 to section 71, creates an exception to the in-house assets rule for instalment warrants that incorporate a borrowing and previously gave the regulators cause for concern under section 67. This creates an exception for instalment warrants that involve investments of any type that the superannuation fund would otherwise be permitted to invest in. As such, these investments may include equity assets that are unlisted as well as other asset classes, such as property, that are also unlisted.

Instalment-style investments that are structured so they do not feature a borrowing (and, hence, are already compliant with section 67) cannot access this exception under the current wording. Instead, they must rely on the Excluded Instalment Trust exception which is limited under the subsection 10(1) definition to listed securities.

It seems strange that instalment arrangements that feature a borrowing enjoy a broader exception than those which do not. Accordingly we recommend the subsection 10(1) definition be expanded, and offer the following wording to illustrate how this might be achieved (expanded term in bold font):

*"excluded instalment trust", of a superannuation fund, means a trust:*

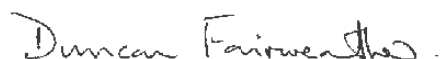
*(a) that arises because a trustee or investment manager of the superannuation fund makes an investment under which ~~a listed security (within the meaning of subsection 66(5))(the underlying security)~~ **an asset which the superannuation fund is not otherwise prohibited by this or any other Act from acquiring** is held in trust until the purchase price of the underlying security is fully paid; and".....*

## 3. Concluding Comments

AFMA participated in Treasury's consultation process on the design of the law, which we believe was a very useful process. We believe the provisions in the Bill will maintain the high level of regulatory protection afforded to superannuation fund investors in instalment warrants.

Thank you for accepting our submission and considering the points that we have raised.

Yours sincerely



**Duncan Fairweather**  
**Executive Director**