FINANCIAL REVIEW

Opinion

Time to outlaw borrowing by self-managed super funds

The Murray Inquiry showed the risk of letting super funds borrow, and the Hayne commission highlighted the abuse of the loophole. Will the Coalition government fix it?

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Will the Coalition government's comprehensive retirement income review finally tackle the vexed and politically fraught question of borrowing by superannuation funds?

Participants in the country's $2.7 trillion super industry eagerly await release of the review, led by former Treasury official Mike Callaghan.

Will the Morrison government have the courage to ban borrowing by super funds now that housing prices are again under downward pressure **Andrew Quilty**

It is expected to cast a critical eye over the super industry's politically sensitive "sacred cows" - such as the level of super guarantee levy, and the generous tax concessions that high-income earners pick up on their super contributions.

But there's also intense speculation over whether the latest review will recommend a ban on direct borrowing by super funds, especially now that house prices in

many major cities are again heading lower.

Of course, that was one of the key recommendations of the Financial System Inquiry, led by former Commonwealth Bank boss David Murray (who is now AMP chairman) and delivered in December 2014.

In its final report, the Murray inquiry noted super funds were increasingly taking advantage of the provision that let them borrow directly using limited recourse borrowing arrangements.

"Over the past five years, the amount of funds borrowed using LRBAs increased almost 18 times, from $497 million in June 2009 to $8.7 billion in June 2014."

Needless to say, this explosion in borrowing by self-managed super funds has only continued. The latest figures from the Australian Taxation Office (ATO) show SMSF borrowings using LBRAs stood at an eye-watering $44.95 billion at the end of last year.

Now the logic of allowing self-managed super funds to borrow using limited recourse loans is that if it happens to default on a loan on one investment property, only that property has to be sold, while the other assets within the super fund are protected.

But as the Murray Inquiry noted, this is faulty logic because bankers usually require the trustees of SMSFs to give personal guarantees on the borrowings.

"In a scenario where there has been a significant reduction in the valuation of an

asset that was purchased using a loan, trustees are likely to sell other assets of the fund to repay a lender, particularly if a personal guarantee is involved.

"As a result, LRBAs are generally unlikely to be effective in limiting losses on one asset from flowing through to other assets, either inside or outside the fund."

No doubt under hectic pressure from both the financial planning industry and from the property industry, the then-Turnbull government rejected the Murray Inquiry's recommendation to ban SMSFs from borrowing to buy property.

Instead, it fudged the issue by instructing the ATO and the Council of Financial Regulators to review the level of borrowing in SMSFs, and to report back after three years.

Since then the Hayne royal commission vindicated the Murray Inquiry's concerns by exposing some of the shoddy practices financial planners engaged in, taking advantage of the lax rules around borrowing by super funds.

Financial planners, who faced tighter rules on pocketing commissions for flogging financial products from mid-2014, were quick to realise the potential fees they could pick up from advising clients to set up self-managed super funds, and then to borrow using LBRAs.

Financial planners were able to pick up lucrative fees for their advice, the work involved in setting up SMSFs, and for ongoing financial advice.

The fact that so many unscrupulous financial planners were taking advantage of lax rules on borrowings by SMSFs to extract huge fees from their hapless clients demonstrates that the Morrison government can't continue to side-step the need to crack down on this glaring loophole.

What's more, as the country struggles to emerge from the coronavirus recession, there's also the national interest to consider.

As Murray told *The Australian Financial Review*, "the reason that we recommended against borrowing by superannuation funds - be they SMSFs or other funds - is that

borrowing magnifies risks and returns.

"We did not want to have financial instability in superannuation funds threatening economic stability, particularly at times when the banking system itself could be exposed to exogenous risks."

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