



SMSF Association Limited Recourse Borrowing Arrangements Industry Best Practice Guidelines

Limited Recourse Borrowing Arrangement (LRBA) Lenders Best Practice Guidelines

These LRBA Lenders' Best Practice Guidelines ("Lenders Guidelines") have been developed from established best practices within the banking industry. The guidelines are intended to establish banking industry standards that can complement individual LRBA Credit Policy and Practices regarding LRBA lending to SMSFs. The Lenders Guidelines should encourage and reinforce prudent lending to SMSFs.

The Lenders' Guidelines require lenders to make appropriate disclosures to SMSF trustees that are considering an LRBA. Further, lenders are required to make a recommendation to the SMSF trustee that they seek appropriate specialist SMSF, financial and legal, advice in regards to their SMSF entering into an LRBA but at the same time recognising the limited role and responsibilities of lenders in this process. Although strongly recommended, it remains the responsibility of the SMSF trustee to determine whether to proceed with obtaining appropriate advice relating to the suitability of an LRBA within their SMSF's investment strategy.

This recommendation will help ensure that SMSF trustees who are considering LRBAs understand the importance of obtaining the appropriate amount of relevant information and knowledge to assist their decision making.

The lenders that are party to these best practice guidelines have their own responsible lending guidelines, and specific Credit Policy requirements which reflect their individual risk appetite, including guidelines specifically for SMSF loans, which ensure that they lend in a prudent manner to SMSF trustees seeking to implement LRBAs.

Being a party to these Lenders Guidelines does not impose any obligation on a lender under or in respect of the LRBA Advice Best Practice Guidelines ("Advice Guidelines"). Lenders who are party to these Lenders Guidelines are not obliged to require a SMSF to:

- obtain advice from an advisor who is a party to the Advice Guidelines; or
- obtain any advice of the nature described in the Advice Guidelines,

before entering into a LRBA with an SMSF.

The Lenders' Guidelines are:

- Recommend an appropriate specialist SMSF, financial or legal advisor be used to provide advice and information.
 - Advice can be provided by lawyers, financial planners and/or accountants with appropriate competencies and licencing arrangements consistent with ASIC's requirements.



- Seek an acknowledgment from SMSF trustees to the lender that they were recommended to seek and receive appropriate specialist SMSF, financial or legal advice.
- Lenders are to provide SMSF trustees with factual information on what an LRBA involves, including but not limited to:
 - What is an LRBA?
 - Advantages/risks of LRBAs.
 - How an LRBA is established?
 - How an LRBA is maintained?
 - What happens on repayment of an LRBA?
 - What happens in the case of an LRBA defaulting?
- SMSF compliance – SMSF trustee certifies that the fund is compliant with SIS obligations.

The LRBA Best Practice Advice Guidelines (“Advice Guidelines”) are proposed to create a best practice standard of advice that should be provided to SMSF trustees considering the use of LRBAs should they elect to seek personal advice. The Advice Guidelines have been developed from established best practices in advice on LRBAs.

The Advice Guidelines should ensure that when an SMSF trustee seeks appropriate advice regarding the suitability of an LRBA for their particular circumstances, they receive advice from a competent and appropriately licensed advisor that allows them to make the most appropriate decision for their SMSF. Obtaining such advice should help to ensure LRBAs are only being invested in by SMSF trustees after understanding the nature of the investment strategy and the risks associated with it.

The Advice Guidelines are:

- Whether the LRBA is an appropriate strategy for the SMSF in light of the members needs and the fund’s circumstances including (but not limited to):
 - Fund balance.
 - Asset concentration.
 - Expected contributions and other fund resources to repay debt.
 - Insurance needs.
- Advisors at a minimum must provide information on and discuss the following topics in the process of recommending an LRBA to an SMSF trustee:
 - LRBA establishment processes and transaction costs.
 - On-going LRBA costs
 - Permitted used of LRBAs under the SIS law
- Single acquirable asset requirements
- Repair/maintain distinction
- Replacement assets
 - Are there alternative strategies to using an LRBA to acquire asset?
 - How does an LRBA fit in the SMSF’s investment strategy?
- Is a borrowing strategy appropriate?
- Large/“lumpy” asset risks
- Appropriate diversification/overweighting in a single asset class
- Risks of investing in a single asset within a fund (if applicable)



- Investment timeframes
- Fund cash flow
- On-going costs

Benefits of LRBA's

- Geared returns
- Expanded investment opportunities
- Portfolio diversification opportunities
- Investment in direct property

Risks of LRBA's

- Increased investment risks associated with leverage
- Loan servicing/cash-flow risks
- Interest rate risk
- Investment/rental income risks
- Asset market price risks
- The requirement for adequate insurance
- SIS law contravention risks
- Ongoing compliance issues and risk of legislative change

Taxation Considerations

- Stamp duty
- Capital gains tax
- Exempt pension income

SMSF Trust Deed Issues

Roles and responsibilities

- SMSF trustee should understand their responsibility in relation to the LRBA as distinct from the responsibilities of the lender and/or any advisor.
- Recommendations on utilising an LRBA must be based on and appropriate for the clients' personal and financial circumstances.
- Where appropriate an advisor may need to recommend that the client seek specialist taxation and legal advice on their LRBA structure.

Disclaimer

This document contains general advice only and is prepared without taking into account particular objectives, financial circumstances and needs. The information provided in this article is not a substitute for legal, tax and financial product advice. Before making any decision based on this information, you should assess its relevance to the individual circumstances of your client. While the SMSF Association believes that the information provided in this article is accurate, no warranty is given as to its accuracy and persons who rely on this information do so at their own risk. The information provided in this bulletin is not considered financial product advice for the purposes of the Corporations Act 2001.