



Stockbrokers and Investment
Advisers Association

Serving the interests of investors

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Via upload

Committee Secretary
Parliamentary Joint Committee on Corporations and Financial Services
PO Box 6100
Parliament House
Canberra ACT 2600

Dear Committee members

Inquiry into the wholesale investor and wholesale client tests

The Stockbrokers and Investment Advisers Association (SIAA) is the professional body for the stockbroking and investment advice industry. Our members are Market Participants and Advisory firms that provide securities and investment advice, execution services and equity capital-raising for Australian investors, both retail and wholesale, and for businesses. Practitioner Members are suitably qualified professionals who are employed in the securities and derivatives industry.

SIAA members represent the full range of advice providers from full-service and online brokers to execution-only participants and they provide wealth advice and portfolio management services.

The history of the stockbroking profession in Australia can be found [here](#).

Thank you for the opportunity to provide feedback on the inquiry into the Corporations Act laws and related regulations on the wholesale investor test for offers of securities and the wholesale client test for financial products and services (wholesale investor tests). We note that our submission is lengthy but the Committee has asked important questions that are important for us to answer.

We are pleased that the government has accepted our recommendation for a standalone consultation and that the Committee's inquiry has terms of reference that cover the impact of the wholesale investor tests more broadly.

SIAA provided comprehensive feedback to the 2023 Treasury review of the regulatory framework for managed investment schemes concerning proposals to change the wholesale client thresholds. A link to our submission to that review is [here](#). We have also attached our discussion paper on the wholesale investor test, which we issued in 2022.

SIAA did not support the changes to the wholesale client thresholds proposed in the Treasury consultation. We pointed out that the regulatory distinction between retail and wholesale clients is applicable to a range of circumstances in the financial services sector and has much broader implications than just for managed investment schemes. We recommended that any review of the wholesale client definition should be subject to a standalone consultation to enable participation by all relevant industry stakeholders to ensure it takes into account all possible consequential impacts.

Executive summary

- SIAA supports a distinction between retail and wholesale investors that provides retail protections to most investors but enables access to the wholesale classification to those who qualify.
- SIAA supports the current wholesale investor definitions. A range of tests is appropriate in order to provide for the diversity and complexity of the financial services industry. Objective tests provide licensees with regulatory certainty. It is also useful for licensees to be able to apply a subjective test for investor financial sophistication.
- Issues with wholesale investments have been with poor products and mis-selling rather than with wholesale investor definitions or thresholds.
- SIAA does not consider that changes need to be made to the current test thresholds. Attention is required to how poor products are marketed, rather than the test thresholds.
- The Design and Distribution Obligations (DDO) regime has been a game changer in the regulation of financial products. Its impact must be taken into account when considering ways to protect consumers from harm.
- SIAA broadly supports the implementation of Recommendation 11 from the Quality of Advice Review. We consider the recommendation should apply to more investor categories and in circumstances where investors receive no advice.
- Any changes to test thresholds would need to carefully consider the impact on existing wholesale investors and their investments. Investor consultation would be vitally important.
- It is important that thresholds are roughly consistent with international limits. Increasing the thresholds would move Australia out of line with international standards.
- In summary, SIAA recommends that the current test thresholds remain in place. Support for this recommendation is set out below.

1. Review of the current wholesale investor tests

Legal requirements

We have set out the legal requirements of the wholesale investor tests in Appendix A. Our submission focusses on the tests most used in our members' businesses being the product test, the professional investor test, the high net worth test and the sophisticated investor test.

Identification of all contexts in which the tests are relevant

High net worth test

The test that is most frequently applied by our member firms to categorise a client as wholesale is the high net worth test that is based on the asset or income threshold. Investors do not automatically become wholesale clients by virtue of their wealth or income; they must actively request this classification by obtaining a certificate from an accountant which must be renewed every two years.

Unless they choose to become a high net worth investor and keep their certification up to date, investors who meet the income or asset threshold are subject to the same restrictions and protections as any other retail investor.

High net worth investors therefore take deliberate steps to opt out of the retail investor regime and consciously sign away protections applied to retail investors by seeking the wholesale certification. Importantly, they must obtain a certificate from a qualified accountant who is required to certify that the investor satisfies either or both of the two limbs of the wealth test.

The high net worth accountant's certificate has to be renewed every two years – it is not a 'set and forget' process. If the certificate expires and is not replaced, the client is no longer a wholesale client under the relevant section of the Corporations Act.

Such a test is easy to apply and transparent to clients. Importantly, it is objective and does not allow a client to 'self-certify' their assets or income. Both full-service and online brokers (that offer a high-volume, no advice service) rely on this test.

Our members consider that it is important that the accountant's certificate is provided by an accountant who is independent of the financial services licensee.

If there is concern as to the issue of the accountant's certificate where such independence does not exist, SIAA therefore recommends that any regulatory focus apply to a test of independence, rather than a change in the threshold tests.

Other tests

Some of our members also apply the \$500,000 product test. Again, their view is that it works well and is a simple 'bright line' test. The client either has that money to invest or they do not.

Our members also apply the professional investor test. Licensees may have a professional investor certificate that a client is required to sign in which they certify that they satisfy one of the definitions of professional investor before they can be treated as a wholesale client. We have not heard of any issues arising from the professional investor test – the client either falls within the category of professional investor or they do not.

Online brokers rely on these 'black and white' tests as they are a high volume, no advice business.

The sophisticated investor test is subjective and not many firms rely solely on it for this reason.

Framework of protections

It is important for the Committee to understand that even though wholesale advice providers may not have specific duties to the client under the Corporations Act nor have to meet the higher threshold of professional standards as their retail counterparts, the provision of wholesale advice is not a regulatory 'free for all'. Wholesale financial licensees and their advisors must adhere to legal obligations and ensure that the financial services provided take place within a legal framework of protections that provides a pathway of recourse for wholesale investors and the market.

Wholesale investors have protections under general law, the Market Integrity Rules and the Corporations Act, specifically:

- those arising from section 912A of the Corporations Act that, amongst other things, require financial services licensees to provide financial services 'efficiently, honestly and fairly'; manage conflicts of interest; comply with financial services laws; ensure their representatives do so as well and are adequately trained and competent,
- the consumer protection provisions of the Corporations Act and ASIC Act including those dealing with misleading and deceptive conduct, unconscionable conduct, representations and warranties, and
- a fiduciary duty to the client.

Wholesale investors can continue to receive general advice and execution-only services and ask for personal advice under contract from their adviser.

Importantly, the regulatory environment for licensees has changed significantly since 2021 with the introduction of the breach reporting obligations that increase protections afforded to wholesale investors and the market.

Questions have arisen during our regular stakeholder engagement with AFCA about how wholesale clients are dealt with by our members. In other words, how does a licensee deal with a complaint brought by a wholesale client when they are not required under the Corporations Act to have an internal dispute resolution scheme that includes membership of AFCA?

Our members have reported (unsurprisingly) that they treat complaints from wholesale clients the same as they do retail clients. While wholesale advice providers are not obliged by law to have an internal dispute resolution service, many have implemented them on a voluntary basis and they operate much the same as the retail requirements. This means that in the first instance they consider the client complaint as part of their internal dispute resolution process. If the client lodges a complaint with AFCA (as some wholesale clients do) the firm can then argue that the client is a wholesale client.

Our members have pointed out that complaints do not 'magically disappear' just because they are made by wholesale clients. All complaints have to be dealt with by the licensee in accordance with their prescribed regulatory obligations.

AFCA continues to accept complaints from wholesale investors, even though the AFCA scheme was established to deal with complaints from retail clients. We have raised our concerns with Treasury and AFCA on a number of occasions that notwithstanding that the external dispute resolution

scheme was never intended for wholesale client complaints, AFCA continues to accept complaints from wholesale clients. We consider that this gives rise to a risk that wholesale clients are therefore able to 'game the system'. In any event, we note that the number of total complaints against stockbrokers are low and any complaints from wholesale clients represent an even lower percentage of the total¹. This suggests not only sound internal dispute resolution processes, but also low instances of client disaffection. This supports our contention that wholesale client views need to be sought as part of the inquiry process. We stress that such research needs to cover wholesale clients who have never lodged a complaint (the majority) rather than focus on the few that have,

The impact that DDO has had on the financial services industry

The DDO regime is an important part of the context.

Our members consider that DDO has been a 'game changer' in the provision of financial products. ASIC has been very active in surveillance and enforcement of DDO and has issued 81 interim stop orders in the exercise of its product intervention power.

SIAA recently provided feedback to APRA on the impact that any change to Additional Tier 1 Capital (hybrid securities) would have on Australian investors which highlighted how the introduction of the DDO regime had resulted in the issuance of hybrid securities being restricted to wholesale clients or personally advised retail clients. Our member firms reported that the vast majority of their clients who held hybrids were either wholesale clients or retail clients who received personal advice. Unadvised retail clients holding hybrids had either acquired hybrid securities on market or acquired the product prior to DDO.

While DDO only applies to products offered to retail clients, a product that is aimed at both retail and wholesale clients must comply with the DDO regime. The introduction of DDO moves the focus from a wholesale investor test to the appropriateness of a financial product. SIAA supports this focus.

Capital raising

It is important to realise that the regulatory distinction between retail and wholesale clients is applicable to a range of circumstances in the financial services sector. The wholesale client definition in Chapter 7 of the Corporations Act mirrors definitional provisions in Chapter 6D of the Corporations Act that deal with capital raising. That means that a client who is a high net worth investor is able to take up an offer of securities without a prospectus. This is an important means of raising capital.

The stockbroking profession has made an incredible contribution to Australia's economic strength, not only in terms of personal wealth creation, but also in the all-important equity formation for Australian companies, ranging from CSL, BHP and CBA down to the smallest and smartest technology and science successes. Australia has a strong culture for individual share market investment by ordinary citizens — the result of decades of public policy driving Australians in that direction.

¹ For the financial year ended 30 June 2023 AFCA received 313 complaints against stockbrokers. For the same period AFCA received a record total of 97,000 complaints.

According to the *ASX Investor Study 2023*, 51% of Australian adults, or 10.2 million people, hold investments outside their primary residence and superannuation. Of these, 7.7 million people hold investments through a stock exchange. An estimated 1.2 million investors have started investing since 2020.

Stockbrokers have a long history of not only providing advice to investors on listed equities, but also working with them to provide capital to the young, growing companies that are the future ASX200. Without shareholders who are willing to take risks that a bank or a bondholder would not, these companies might remain stuck in low gear or never even get moving. It is unusual for large institutional investors to invest in these companies. Any change to the wholesale investor tests that limits investor access to capital raisings denies them the growth opportunities offered by ASX200 and weakens the opportunities for small listed entities to access much-needed capital.

The wholesale investor classification is not only relevant to capital raising for listed entities. It also enables wholesale investors to access opportunities in private equity, venture capital and seed rounds for early stage start-ups.

The impact of any change on the capacity of Australian businesses to access capital, with the concomitant impact on the Australian economy, is a key issue that needs to be considered when reviewing whether wholesale investor tests need to change.

Consequences of an investor/client meeting the relevant test

There are important consequences of being treated as a wholesale client, namely:

- the adviser will not have to comply with the professional standards (Code of Ethics, Education and Training) that apply to those who provide personal advice to retail clients
- the advice provider will not have a duty to act in the best interests of the client under the Corporations Act (but see our previous comments about general fiduciary duties owed to clients and licensees' duties under section 912A of the Corporations Act)
- the advice provider is not required to provide the client with a statement of advice
- the advice provider is not required to give the client a product disclosure statement or financial services guide, and
- the client will not be entitled to complain about the advice under the AFS licensee's internal dispute resolution procedures or to AFCA (but see our previous comments about AFCA accepting complaints from wholesale clients and how our members deal with wholesale client complaints).

Wrongly classifying a client as a wholesale investor can give rise to significant regulatory penalties.

For example, a licensee who wrongly classifies a client as a wholesale client (when they are in fact a retail client) and fails to provide the client with a statement of advice breaches section 946A of the Corporations Act which is a civil penalty provision.

The application of the tests in practice

There is an assumption in much of the commentary on the wholesale investor tests that a client can be treated as a wholesale client without either their knowledge or requiring their consent or by persuading them to become a wholesale investor by virtue of a 'push' from an adviser. This is not how the tests are applied in practice.

How clients are categorised

In practice, licensees providing advice in the stockbroking and investment advice industry take a nuanced approach to categorising clients as wholesale. They rely on the high net worth test as an objective measure while also taking into account the sophistication and financial knowledge of the client.

Licensees understand that a client's asset level is not always a reliable indicator of financial knowledge or sophistication. A client who is able to satisfy the asset threshold of the high net worth test can be certified as a wholesale client, but this is often just the start of a journey, with the licensee going beyond the Corporations Act definition.

Some licensees have a matrix test that is used to evaluate whether a client who satisfies the asset or income threshold should be treated as wholesale once their investment experience and knowledge is taken into account. Another approach is to have a sophisticated investor panel that solicits details of the investor's experience, which includes years of investing, qualifications and occupation and assesses whether they are to be categorised as wholesale. One example of an investor with a high level of financial literacy would be a director of a public company, given that they have a duty to be able to review and understand financial statements.

Licensees have in many instances developed robust processes for onboarding wholesale clients that ensure they are aware of the consequences of no longer being categorised as retail, with clients required to sign and return an acknowledgement letter. Clients are advised as part of this process that they can 'opt-in' to retail if they decide they no longer want to be classified as wholesale.

Importantly, under these processes, an adviser cannot simply categorise a client as wholesale — the application must be put before compliance personnel and a control process is applied. The licensee adds the client as a wholesale investor and the adviser cannot interfere in that process. Any queries are referred to compliance.

These processes form part of a licensee's overall compliance and risk management framework and ensure that decisions about wholesale clients are made by the licensee, not the adviser, and there is appropriate supervision and monitoring of the client's account and the risks involved.

Some of our members who offer an online service and who rely on the high net worth test also require their wholesale clients to sign a form acknowledging that they have been categorised as a wholesale client and the consequences of that decision.

2. The historical development in Australia of the wholesale investor tests and consideration of any previous reviews and inquiries

A summary of the development of the wholesale investor tests and previous reviews and inquiries is contained in Appendix B.

3. Comparison with comparable overseas jurisdictions, including any proposed or recent changes to tests used in similar contexts

It is worth noting that Australia's monetary thresholds are not outliers when it comes to the threshold for wholesale investors.

Country	Net Asset Worth (in equivalent AUD)	Gross Income (in equivalent AUD)
Australia	\$2.5 million	\$250,000
USA	\$1.55 million (approximately) (USD1 million)	\$232,838 single or \$465,676 couple/partners (USD300,000 combined)
UK	\$492,500 excluding home & super (£250,000 excluding home & pensions)	\$200,000 (£100,000)

Our members' feedback is that wholesale investor thresholds need to remain roughly consistent with international limits to support international distribution of financial products. Increasing the thresholds would move Australia out of line with international standards.

4. Consideration of any proposals to changes the wholesale investor tests

Calls for change to the wholesale investor test have come from legal academics, members of the legal profession and some parts of the financial advice sector itself. Most of the criticisms focus on the high net worth test and in particular the net asset threshold of \$2.5 million, as no longer being satisfactory as a proxy for financial knowledge.

Drivers of calls for change

The strongest driver for the calls for changes to the assets test threshold is the increase in house prices in Sydney and Melbourne. Those wanting an increase to the \$2.5 million net asset threshold argue that it is easy for clients who own a house in Sydney or Melbourne to satisfy the test, even if they lack financial knowledge. While house prices have increased substantially in Australia's largest cities since the threshold was introduced, house prices in Australia's regional and rural areas or in capital cities such as Perth and Adelaide have not reached the heights of those on the eastern seaboard. Increasing the threshold for the net assets test will have a disproportionate impact on clients who own real estate in those areas, excluding investors in the regions and a number of capital

cities from accessing investment opportunities available to wholesale clients. A Sydney/Melbourne-centric view of Australian investors is narrow and does not take into account the perspectives of those living outside of these cities.

Another driver is that when the tests were introduced, two per cent of the population met the criteria while now 16% meet the criteria and the argument is that the tests now apply to too many Australians. However, this reasoning does not take account of the growth in wealth of the Australian population since the tests were introduced. The combined net worth of all Australians was \$1.299 trillion in March 1989. Adjusted for inflation, that's equivalent to around \$3.26 trillion in today's money per the RBA's inflation calculator. That means in real terms, the current net worth of Australian households is 380% higher than in 1989, despite the adult population only being 70.5% higher at just over 12.25 million. However, the current net wealth of Australian households is much higher than \$3.26 trillion. As at the end of the September 2023 quarter, according to the ABS, the net wealth of Australian households was \$15.31 trillion. According to the Credit Suisse 2023 Global Wealth Report, in 2022 mean wealth per adult in Australia was USD\$497k - the fourth-highest behind Switzerland, the US and Hong Kong. In 2022, Australia's **median** wealth per adult was more than USD\$247k (about AUD\$356k at the time) - the second highest in the world after Belgium.²

It is appropriate therefore that the tests now apply to a larger percentage of the population than they did in 2001.

Evidence to support such proposals – is there any evidence of harm?

In 2022 SIAA issued a discussion paper examining the question of whether the wholesale investor test should change. Our paper (**which is attached**) addressed the issues of:

- whether there is evidence of harm to support calls for change
- how the test is applied in practice
- existing regulatory protections for wholesale investors and
- the consequences for advisers and investors of a change in the test

and concluded that calls for change to the wholesale investor test have not yet evidenced a market failure that would support them. Our views on this have not changed.

SIAA has yet to be presented with evidence that there is a market failure in relation to financial advice servicing the higher end of the income and asset distribution, particularly when such individuals have taken deliberate steps to opt out of the retail investor regime. Without evidence of harm or a market failure, SIAA does not consider that there are sufficient grounds to introduce law reform.

In support of arguments for change to the wholesale investor tests as part of its review of managed investment schemes, Treasury provided details of various managed investment scheme failures. We pointed out in our submission that many of these schemes were sold to both wholesale and retail clients and pre-dated the introduction of the DDO regime. Client losses incurred in those schemes were not due to the wholesale investor test thresholds, but to the features and circumstances of the

² Harry O'Sullivan, 'How wealthy are Australians?', savings.com.au, 23 April 2024: Based on ABS data

schemes themselves and the manner in which they were marketed. In the matter of the Trio Capital collapse, investors were the victims of fraud.

SIAA does not consider that failures of these schemes should be used as a reason to change the wholesale client test either for managed investment schemes in particular, or more generally.

Reference has also been made to Mayfair 101 as evidence of the shortcomings of the wholesale investor test. What was made clear in that case was that 'red flags' regarding the operation of the Mayfair group of companies had been raised well before ASIC brought proceedings. Concerns had been raised about the nature of Mayfair's offer and its mass-marketing to a broad population rather than with the wholesale investor test. ASIC's actions against Mayfair were based on evidence of false, misleading and deceptive conduct. Moreover, it was made clear that the false, misleading and deceptive provisions of the Corporations Act and the ASIC Act apply irrespective of whether a product is offered to retail or wholesale investors. As ASIC Deputy Chair, Karen Chester stated "ASIC's success in court.....demonstrates firms need to do the right thing by their investors, even when they are wholesale investors."

Arguments in favour of change need to consider the regulatory context, how the wholesale investor test is applied in practice and the impact that change would have on investors. It is also important to consider the impact that DDO has had on the financial services industry. Any changes would have wide-ranging consequences and involve important trade-offs. These are important considerations when considering whether a policy change is justified.

Possible consequences (both intended and unintended) of any change to the wholesale investor tests

The costs and benefits of any change

Product value test

We do not support an increase in the financial threshold for the product value test.

\$500,000 is a significant amount for an individual investment in one product. There are concerns that raising the \$500,000 limit will make wholesale investments even less accessible to individual investors. Any increase will also make it harder for wholesale investors to build diversified portfolios.

Some product issuers rely solely on the product value test. The distribution potential for their products would be severely impacted if the threshold was increased.

Any increase in the product test will have an impact on capital markets, including the market for OTC products. It will also impact the ability of banks to raise capital.

We question if complaints have arisen from clients investing under this classification. To date, none have come to our attention.

High net worth test

We do not support reform that would eliminate an objective test. An objective test is important for our members to achieve compliance certainty as the penalties for non-compliance are high. This is equally the case whether the licensee is providing advice to the client or not. Importantly, an objective test is necessary for online brokers as they do not provide personal advice to their clients

and are not in the position to exercise professional judgement to determine whether the client is a wholesale investor on subjective grounds.

We do not consider that there is any evidence that supports an increase in the financial thresholds for the net assets and/or gross income wealth test.

There has been very little wage inflation in recent years in Australia. A gross income of \$250,000 is a significant multiple of average earnings. The Australian Bureau of Statistics reports the average weekly ordinary time earnings for full-time adults at currently \$1,838.10 (\$95,581.20 per annum), with skilled and experienced workers earning \$108,000 per annum.

Clients in regional and rural areas and capital cities other than Sydney and Melbourne would need to be consulted as to whether they support a change to the wholesale investor test. It is hard to see the fairness in a situation where a wholesale investor in Perth, for example, who participates in capital raisings of mining companies, is told they can no longer do so because the asset and or income thresholds have been raised to take into account assets and incomes in the capital cities of the eastern states.

As with the proposal to increase the product value test, increasing the thresholds would reduce accessibility to investors who could benefit from wholesale products. It would also restrict the market for wholesale products with a resultant reduction in supply.

The professional investor test and the sophisticated investor test

We do not consider that there is any evidence that supports a change to the professional investor test.

We comment below on the proposal to introduce a consent requirement in accordance with Recommendation 11 of the Quality of Advice Review that could be adapted to cover sophisticated investors. Otherwise, we do not support a change to the sophisticated investor test.

The impacts of any change on different cohorts of investor/client and other stakeholders

It is important to note that calls for change to the wholesale investor tests and asset thresholds are not coming from investors. Evidence that licensees are 'pushing' clients into becoming wholesale or systematically gaming the system has not been put forward. Opinion pieces that call for change say much about the fact that the thresholds have not changed since 2001, but provide no evidence of harm other than references to the failed management investment schemes noted earlier where the structure of the scheme was the problem, or Mayfair, which resulted from misleading and deceptive conduct.

We consider that clients would need to be surveyed to obtain their perspective on changes to the test. This is because any change to the wholesale client monetary thresholds would have a significant impact on clients, if the consequence of the change was that they would no longer be classified as wholesale. This would result in them no longer being able to access wholesale products and, depending on the circumstances of any change, being forced to rearrange their portfolios to sell down their wholesale products and replace them with retail products. Such a change could disadvantage a significant cohort of Australian investors who have not been consulted on their views

of whether such a change is welcomed by them. It would have implications for retirement income strategies for older Australians and wealth generation for younger Australians.

Our members report that it is challenging to measure the impact that an increase in the net asset test threshold would have on the classification of their wholesale clients. An accountant's certificate is only required to certify that the client has net assets of at least \$2.5 million. It is not required to certify every asset the client has. However, one of our members has estimated that approximately 50% of their wholesale clients would lose their classification in the event the net asset threshold was increased to \$5 million.

Losing access to advice

In the wholesale advice sector, the relationship between adviser and client is often closely fostered by the adviser and is based on trust developed over a number of years. Changes to the test could result in them losing access to their adviser of choice.

Licensees have aligned their business model to the current regulatory framework, including the wholesale client definitions. Advisers with a wholesale-client-only business model are not required to satisfy the professional standards that allow them to provide advice to retail clients. To provide advice to retail clients an adviser must have:

- completed an approved degree
- passed the national adviser exam, and
- completed a Professional Year.

The Professional Year requirement is in effect an apprenticeship. This would leave the adviser without a livelihood for a period of time, making it unlikely that a wholesale-client-only adviser would re-train.

That would mean that a wholesale client who is re-classified as a retail client is very likely to lose their adviser. This may not be such a significant issue if there were sufficient numbers of retail client advisers. However, that is not the case. **As of 2 May 2024, there are 15, 597 financial advisers** able to provide advice to retail clients. In comparison, in 2018 there were 28,353. Additionally, due to the restrictive and inflexible nature of the retail adviser education standard, only 381 new entrants joined and remained in the profession in 2023. This will compound the existing problem of Australians having limited access to financial advice.

On the reverse side of this, and as a result of the retail adviser education standard, wholesale-only advisers who did not retrain should regulatory change be implemented will lose their client base and their business if their clients are reclassified as retail.

We recognise that there are calls to increase the assets and income test and implement a transition period of two years in which people with assets between \$2.5 million and the oft-quoted figure of \$5 million can opt in to remain accredited as wholesale if they choose.³ However, the fundamental problem would remain that after the two-year period, if these clients chose to become retail clients,

³ The Financial Services Council in its *White paper on Financial Advice*, issued in October 2021, advocated for the increase of the threshold for the assets test from \$2.5 million to \$5 million and thereafter indexing it to the Consumer Price Index.

it is unlikely that their advisers would retrain as retail client advisers. These clients would therefore become orphaned. If they are unable to find a retail client adviser — a strong possibility given the decline in retail adviser numbers to 15,600 in May 2024 and the fact that new entrant numbers are extremely low (only 381 in 2023) — their only option is to be a self-directed client and receive no advice. If they are able to find a retail adviser to provide them with advice, they will have to rebuild the relationship of trust with that adviser. If it takes time to find a retail adviser, due to the lack of retail adviser numbers, the lack of advice for that period of time may impact their investment position.

In its *2021 Financial Advice Report*, Investment Trends estimates that although 1.8 million people receive advice each year, that represents only about 10% of adults. It also reported an increasing number of Australians (61%) who say they have unmet advice needs. Estimates of \$3.5 trillion or an average of about \$175 billion per year is expected to transfer between generations in the next two decades.⁴ According to recent data from the Australian Bureau of Statistics, some 140,000 people retired in 2020. Over 670,000 people intend to retire in the next five years, with 220,000 in the next two years.

There has never been a time when access to financial advice is more important to so many Australians and it is so difficult to obtain. A change to the wholesale investor tests would compound the difficulty.

Access to wholesale products and strategies

The wholesale client classification enables clients to access wholesale client opportunities and products. Examples of wholesale products include alternative investments such as hedge funds, private equity, venture capital and real assets. These products can diversify and enhance investment portfolio returns. Alternatives can increase the return potential of a portfolio through access to a broader set of investment strategies. With a low correlation to traditional asset classes, an investment in alternatives can be a beneficial way to enhance diversification within a portfolio. By investing in alternatives, diversification can be increased, which can lead to a more desirable risk-return profile for a balanced portfolio.

Licensees have structured their businesses to meet this demand. Advisers and clients have built their investing strategy on the current model. Any change that results in a wholesale client being reclassified will impact on the products and strategies they can invest in and could result in them having to sell out of their wholesale products. This will cause significant disruption and attendant costs.

Our online broking members tell us that this would also impact their self-directed wholesale clients who chose to access wholesale products on a no-advice basis.

The example of hybrid securities

One issue that highlights the impact that a change in thresholds would have on a particular cohort of investors is that of hybrid securities.

⁴ Productivity Commission, *Wealth transfers and their economic effects: research paper*, November 2021.

Our member firms report that Investors who seek income, particularly those in retirement, are prepared to take credit risk by moving down the capital structures of financially strong and well managed institutions and acquire hybrids for the income stream. The bond market is not available to those unable to invest the minimum amount of \$500,000, so hybrids are a more accessible way to achieve income. Investors make these investments in knowledge of the features — including the risks — of hybrids. An advantage of acquiring hybrids on issuance is that investors are not charged fees.

As a consequence of the DDO regime, hybrids can only be issued to retail investors who have received advice on the product. Unadvised (self-directed) investors can only acquire hybrid securities on issuance if they are categorised as wholesale investors.

Any changes to the thresholds that result in wholesale investors losing their wholesale status, would impact on their ability to acquire hybrid securities on issuance. We are concerned about the impact that any changes would have on Australian investors, particularly those that prevent certain investors from acquiring hybrid securities. There would be a significant negative impact on the income of Australians in retirement.

Impact on capital raising

Any changes in the wholesale investor definitions in Chapter 7 that lead to inconsistency between it and Chapter 6D would result in clients who are classified as wholesale for one purpose being ineligible to be treated as wholesale for another. This would be unworkable for stockbrokers and investment advisers as well as being confusing and frustrating for their clients.

It would also have significant consequences for capital raising as it would shrink the pool of investors able to participate in offerings, both listed and unlisted. Any change to the wholesale client thresholds would particularly impact smaller entities listing on the ASX and the ability of early stage start-ups to attract capital through private equity, venture capital and angel investors.

Intergenerational equity

An important matter that is often overlooked when considering the impact of changes to the wholesale investor tests on different cohorts of investors is that of intergenerational equity. Young investors who are trying to build wealth are seeking to access wholesale products. If they can satisfy the thresholds of the high net worth test they are able to do so. Any change to the thresholds essentially ‘moves the goalposts’ for that cohort of investors, increasing the gap between them and older generations in terms of capacity to generate wealth.

5. Potential adjustments to proposals to change the wholesale investor/client tests to address the concerns of stakeholders

Indexing the monetary thresholds of the high net worth and product tests

Applying an index to the asset or income thresholds or the product test increases complexity and reduces transparency. It would add uncertainty to determining whether a client meets the requirements or not and would not take into account financial market corrections. Our members

have told us that indexation would create a constantly moving goalpost which would significantly impact their business, particularly their compliance operations.

Our members advise that the cost of numerous regulatory reforms over the past few years has resulted in significant investment resources being allocated to ensuring compliance with a multiplicity of obligations, many of which have been shown to be of no benefit to the client. The investment required to keep track of a constantly moving goalpost if indexation was applied to the test would be very significant indeed.

Excluding the family home from the net assets tests

Excluding the family home when determining an individual's net assets for the purposes of the high net worth test would have the following impacts:

- Advantage those clients who do not own a home and have invested in other assets while disadvantaging those who have decided to place their wealth in their family home.
- Exclude a number of clients who are currently classified as wholesale and wish to remain categorised as such.
- Create an additional layer of complexity for investors who own a business, particularly in circumstances where the family home serves a dual purpose such as, for example, rural property that includes the family home and the business.

We consider that the regulatory focus should not be on the manner in which clients choose to invest their wealth.

Introducing a knowledge test

Some commentators have called for the introduction of an investor knowledge test that a client would be required to pass to be classified as a wholesale investor. Those advocating for this proposal point to wealth not being a suitable proxy for financial sophistication.

In response to this idea, SIAA developed a draft financial literacy test to assess whether members could use it to qualitatively assess their clients' understanding of risk, volatility and products.

Our members reported that their clients were unlikely to agree to sit the knowledge test, which would be perceived by them to be an exam.

More generally, it would be difficult for a knowledge test to be implemented across the industry. We were unsure how online brokers who don't provide advice to clients could implement a knowledge test for self-directed investors. They require a 'black and white' test, which the current tests provide.

Additionally, many wholesale product providers deal directly with clients, rather than via intermediaries such as our members. Mandating a knowledge test for wholesale clients who acquire wholesale products through their broker or investment adviser would disadvantage those businesses compared with issuers who deal with wholesale investors direct. It could also drive investors away from receiving advice, which we believe would be an unfortunate outcome, given that the majority of issues, as noted earlier, are with products and not advice.

Introducing a consent requirement in accordance with Recommendation 11 of the Quality of Advice Review

SIAA broadly supports the implementation of Recommendation 11 of the Quality of Advice Review. Many of our members obtain a consent or acknowledgement from the client in addition to a qualified accountant's certificate in the case of the high net worth test, and the product value test, so the Recommendation is not out of step with the practice of many of our members. We consider that this additional disclosure will allow clients to make more informed decisions in this regard.

We note that the recommended wording of the consent overlooks the protections that are available to wholesale clients and could be modified to take these into account.

Recommendation 11 only refers to the high net worth test and the sophisticated investor test and does not refer to the product value test. The proposed wording of the consent refers to an advice provider and would not be appropriate in a self-directed setting. Therefore, if Recommendation 11 was adopted more broadly, it would need to be adapted for the various wholesale investor categories and to take into account whether the investor is receiving advice. We consider that this would be a good idea.

For self-directed clients, it would be important that the consent contains acknowledgment of the loss of retail protections (including the provision of disclosure documents such as the Financial Service Guide, Product Disclosure Statement as well as other protections such as access to AFCA) and the consequences of this. It may also be helpful for the client to confirm that they have the knowledge and or experience to make decisions without these disclosure documents.

We understand the desire to protect investors from harm and support regulation that gives effect to this. A wholesale or sophisticated investor is deemed to be in a position to assess and understand the risks of an investment offer. While there is recognition that a monetary threshold test is not a proxy for financial literacy, a consent form invokes investor responsibility, which should be encouraged. It should also be recognised that if investors do not understand the offer or the risk attached to it, they should not be investing in it. This applies whether an investor has \$2.5 million or \$5 million.

Placing a positive obligation upon investors to provide consent before becoming a wholesale client, provides evidence that the client has the necessary knowledge and experience to be a wholesale investor as well as an understanding of the retail protections they have relinquished.

While the content for the consent should be standardised, we recommend that any change to the wholesale investor test to introduce requirements regarding client consent should be at a high level to avoid the significant issues resulting from the over-prescriptive nature of the FDS consent forms that were introduced following the Hayne Royal Commission. Consent forms are best developed by licensees in a way that best suits their business and clients. Professional bodies can also play a useful role in developing consistent forms.

We would not want to see different product issuers developing different consent forms. This will cause confusion for investors.

We do not consider that consent is necessary or appropriate for the professional investor category.

6. Process to be adopted prior to settling any change to the wholesale investor tests

Additional government consultation process

We support the implementation of Recommendation 11 of the Quality of Advice Review adapted to cover more categories of investor such as those qualifying under the product value test. We also support the consent form being implemented for those investors who receive no advice.

We encourage the Committee to recommend that this reform be implemented as soon as possible.

We do not support any other changes to the current tests or thresholds. Any consideration of such changes would require consultation that included the views of wholesale investors who would be losing their wholesale client classification.

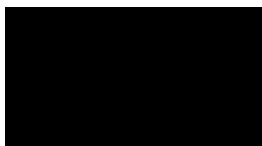
7. Related matters

We currently have no related matters we wish to raise with the Committee.

Conclusion

If you require additional information or wish to discuss this submission in greater detail please do not hesitate to contact SIAA's policy manager, Michelle Huckel, using the contact details in the covering email.

Yours faithfully



Judith Fox
Chief Executive Officer

Appendix A

1. Review of the current wholesale investor tests

Legal requirements

The tests

There is more than one test in the legislation.

All clients are retail unless they are categorised as wholesale.

The tests in Chapter 7 and Chapter 6D mirror each other. Chapter 7 deals with financial services and markets while Chapter 6D enables companies to make offers of securities to wholesale clients without having to issue a prospectus.

Insurance, superannuation, retirement savings account products and traditional trustee company services are treated differently.

The product test

Except when advice relates to superannuation or general insurance, a person is a wholesale client under section 761G of the Corporations Act if the price for the provision of the financial product, or the value of the financial product to which the financial service relates, equals or exceeds \$500,000.

The mirrored section in Chapter 6D is section 708 (8) (a) and (b).

The \$500,000 threshold is effectively a carryover from the same figure adopted as the point of exclusion of prospectus requirements in 1991.

The professional investor test

A professional investor is essentially an entity that has already satisfied certain licensing, registration or listing requirements and, or has control of a substantial amount of money.

Except when the product or service relates to superannuation or general insurance, a person is a wholesale client if they are a professional investor. This includes:

- Australian Financial Services Licensees
- APRA regulated bodies
- trustees of public superannuation funds
- listed entities
- persons controlling at least \$10 million
- the trustee of a superannuation fund which has net assets of at least \$10 million.

The professional investor test is contained in Chapter 6D in section 708 (11) and in Chapter 7 in section 761G (7) (d).

The high net worth test

Except when the product or service relates to superannuation or general insurance, if the financial product or service is not provided for use in connection with a business and the person acquiring the financial product or service provides a certificate from a qualified accountant, obtained within the prior 6 months, that they have:

- net assets of at least \$2.5 million, or
- a gross income for each of the past 2 financial years of at least \$250,000

The product or service will be provided to a wholesale client.

These thresholds are set out in the corporations regulations.

Clients categorised as wholesale clients under this test are also referred to as high net worth clients or (confusingly) sophisticated investors.

The high net worth test is contained in Chapter 6D in section 708 (8) (c) and in Chapter 7 in section 761 G (7) (c).

A qualified accountant is defined by the *ASIC Corporations (Qualified Accountant) Instrument 2016/786* as a person who belongs to one of the following professional bodies at the declared membership classification and comply with that body's CPD requirements:

Professional body	Classification
Chartered Accountants Australia and New Zealand	CA, ACA, FCA
CPA Australia	CPA, FCPA
Institute of Public Accountants	AIPA, MIPA, FIPA

ASIC has provided details on how to determine a client's assets and income and a sample accountant's certificate on its website (<https://asic.gov.au/regulatory-resources/financial-services/financial-product-disclosure/certificates-issued-by-a-qualified-accountant/>) and states that that decisions about how the gross income and net assets are measured for the purposes of the calculations under the certificate are matters the Corporations Act has left to the qualified accountants' professional judgement.

ASIC provides some tips for issuers wanting to rely on the accountant's certificate that are relevant for licensees. The relevant sections of the Corporations Act permit issuers to rely on the face of the certificate unless they have actual knowledge that the certificate is incorrect. There is no need for issuers to inquire behind the certificate if they are satisfied the certificate:

- is issued by a person who is a qualified accountant who holds a class of membership of one of the professional bodies in the class order and states they comply with that body's professional education requirements
- is dated and it is less than 2 years since it was issued at the time the client is offered the securities or financial product
- is clear about which Chapter or Chapters of the Corporations Act it is issued under

- if used in relation to a Chapter 7 financial product or service the issuer must satisfy themselves additionally that the product or service is not used in connection with a business
- says the person to whom the offer is made has a gross income of \$250,000 or more in each of the preceding two years (before the certificate was issued) or net assets of at least \$2.5 million.

Sophisticated investor test

This test focuses on experience in relation to financial products or financial services generally.

Sophisticated investors are also referred to as experienced investors.

Under section 761GA of the Corporations Act a financial product or a financial service in relation to a financial product (for example, financial product advice) is not provided to a person as a retail client (referred to in the heading to the section as a 'sophisticated investor') if:

- the product or service is provided by an AFS licensee
- the product or service is not provided to the client for use in connection with a business
- the AFS licensee providing the service is satisfied on reasonable grounds that the client has previous experience in using financial services and investing in financial products that allows the client to assess the merits of the product or service, the value of the product or service, the risks associated with holding the product, the client's own information needs and the adequacy of the information given by the licensee and the product issuers
- the licensee gives the client a statement about why they are satisfied about these things, and
- the client signs a written acknowledgement before or at the time the product or service is provided that the licensee:
 - has not given the client a product disclosure statement
 - has not given the client any other document that would have been required to have been given to a retail client, and
- does not have any other obligations to the client that they would have had if the product or service had been provided to a retail client.

These provisions are mirrored in section 708 (10) of Chapter 6D of the Corporations Act.

Appendix B

2. The historical development in Australia of the wholesale investor tests and consideration of any previous reviews and inquiries

Background

A distinction between retail and wholesale clients was inserted into the Corporations Act by the Financial Services Reform Act 2001 developed in response to the recommendations of the Wallis Inquiry released in March 1997.

The main motivation for drawing the distinction between retail and wholesale clients was to identify those considered in need of regulatory protection, as well as the desire to allow certain clients to participate in wholesale markets which tend to trade more complex products. Consumer protection provisions would only apply to retail clients as it was recognised that wholesale clients did not require the same level of protection, as they are better informed and better able to assess the risks involved in financial transactions. Wholesale investors are also better able to fend for themselves financially if a dispute arises or sustain the risk of loss. Insurance and superannuation were treated differently, but investors in other financial products could be treated as wholesale clients if they satisfy certain tests: product value, professional investors; small businesses; and individual wealth.

Treasury 2011 Review

Treasury undertook a consultation in January 2011 as part of the Future of Financial Advice reforms on various options for the criteria under which a client was considered to be wholesale or retail in the context of receipt of financial advice.

There was concern that during the global financial crisis many investors suffered losses, because monetary thresholds do not accurately measure the financial literacy of investors and can fail to protect wealthy investors with limited investment experience. Options presented in the consultation paper included:

- indexing the wealth tests so that they remain relevant over time
- excluding the client's primary residence (family home) and superannuation from the net wealth threshold
- changing the process by which clients are deemed to be wholesale to require specific acknowledgement from the client that they will be classed as a wholesale client and they will not receive the benefit of protections provided to retail clients
- repealing the 'sophisticated investor' test on the basis that it is scarcely used and is subjective
- removing the distinction between wholesale and retail clients, thus ensuring high levels of investor protection
- eliminating the wealth thresholds and introducing a 'sophisticated investor' test as the sole way to distinguish between wholesale and retail clients.

The consultation paper noted that “Arguably the approach to defining ‘sophisticated investors’ is a more appropriate way to distinguish whether they are able to deal with complex financial products than a simple wealth test. Although, the subjective nature of the ‘sophisticated investor’ test places the onus on the licensee, creates less certainty and makes it difficult to determine if a [accountant’s] certificate was properly issued.”

There was no consensus in the 30 submissions Treasury received in response to the consultation. Some responses noted that the distinction between retail and wholesale clients permeated the whole fabric of financial services regulation and consequently the way the financial services industry is structured and there was no evidence to suggest that further increases in the monetary thresholds would continue to correlate with financial literacy and experience. Others called for an increase in and indexing of the monetary thresholds and the exclusion of the family home from the assets test. In its response to the consultation, SIAA queried the lack of a clear rationale behind the proposals and raised concerns about the possible detrimental effects of the proposals on capital raising, particularly in the small and mid-cap sectors. The government took no action in response to the consultation and the individual wealth test remained unchanged.

Hayne Royal Commission

There was no consideration of wholesale client issues by the Hayne Royal Commission. The topic did not appear to come up during the public hearings and was not mentioned in either the interim or final report.

Quality of Advice Review

The terms of reference of the Quality of Advice Review included a review of the examination of the legislative framework for financial advice, specifically whether consent arrangements for sophisticated investors and wholesale clients were working effectively for the purposes of financial advice.

The final report recommended (Recommendation 11) that the Corporations Act be amended so that a client must consent to being treated as a wholesale client under the assets and income threshold, in addition to the requirement of an accountant’s certificate.

The written consent should contain an acknowledgement that is given before they are provided with a financial product or service that:

- the advice provider is not required to be a relevant provider and accordingly they will not have to comply with the professional standards
- the advice provider will not have a duty to give good advice or to act in the best interests of the client under the Corporations Act
- the advice provider is not required to give the client a product disclosure statement or financial services guide, and
- the client will not be entitled to complain about the advice under the AFS licensee’s internal dispute resolution procedures or to AFCA.

The Final Report also recommended that the existing consent requirements for sophisticated investors be amended to require a written acknowledgement in the same terms.

In its overview of the Delivering Better Financial Outcomes package in December 2023, the government stated that it was considering Recommendation 11 as part of Treasury's review into managed investment schemes.

Treasury 2023 review of the regulatory framework for managed investment schemes

In September 2023 Treasury undertook a review of the regulatory framework for managed investment schemes that included a review of the wholesale client thresholds in particular:

- Should the financial threshold for the product value test be increased? If so, increased to what value and why?
- Should the financial thresholds for the net assets and/or gross income in the individual wealth test be increased? If so, increased to what value and why?
- Should certain assets be excluded when determining an individual's net assets for the purposes of the individual wealth test? If so, which assets and why?
- If consent requirements were to be introduced:
 - How could these be designed to ensure investors understand the consequences of being considered a wholesale client?
 - Should the same consent requirements be introduced for each wholesale client test (or revised in the case of the sophisticated investor test) in Chapter 7 of the Corporations Act? If not, why not?

Proposal

Financial Services Council White paper

The Financial Services Council (FSC) in its *White Paper on Financial Advice*, issued in October 2021, advocated for the definition of retail and wholesale client to be amended to ensure a greater proportion of financial advice consumers are considered to be retail clients and fall within the consumer protection framework.

The FSC recommended:

- the retention of the distinction between wholesale and retail clients as well as an objective test
- increasing the threshold for the assets test from \$2.5 million to \$5 million in 2023 and thereafter indexing it to the Consumer Price Index
- retaining the other tests unchanged including the \$250,000 income threshold
- allowing existing wholesale clients that would be reclassified as retail as a result of the change to remain wholesale if an election is made within a two-year transition period
- the government to undertake a review, following the completion of the FASEA transition period in 2026, whether an objective threshold is necessary or should be replaced by a

provision allowing financial advisers to use their professional judgement to determine who is a wholesale client, as guided by the statutory best interests duty and code of ethics framework.



Stockbrokers and Investment
Advisers Association

Serving the interests of investors



Does the wholesale investor test need to change?

Stockbrokers and Investment Advisers Association

DISCUSSION PAPER

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Scrutiny of the wholesale investor test

Calls for change to the wholesale investor test from members of academia, the legal profession and the financial advice industry itself have increased in frequency over the past few years. The argument for change is based primarily on the fact that the monetary threshold tests have not been amended since they were introduced in 2002 and the impact of inflation, alongside the sustained boom in Australian home values in parts of the country, has seen the number who qualify as wholesale increase significantly.

Evidence-informed policy proposes that public policy decisions should be based on, or informed by, objective evidence. The implied contrast is with policymaking based on ideology, anecdotes and intuitions.

There is currently recognition that well-intentioned but ill-founded policy and regulation has had a deleterious impact on access to and affordability of financial advice over the past few years. The unintended negative consequences of those policy changes are now subject to consideration as to how best to ameliorate them, with recognition from both the Government and Opposition that a different approach is required. Given the significant implications for financial advisers and their clients should any change to the wholesale investor test be introduced, it is important that any call for change be supported by evidence.

This paper addresses the issues of:

- whether there is evidence of harm to support calls for change
- how the test is applied in practice
- existing regulatory protections for wholesale investors and the consequences for advisers and investors of a change in the test.

The appendix covers the background to the current form of the test and looks at international comparisons.

The aim is to facilitate an informed discussion about the wholesale investor test as two reviews in 2022 are seeking feedback on whether this test should change. The Government has issued *Quality of Advice Review – Draft Terms of Reference* for consultation (which closes on 4 February 2022). The draft Terms of Reference note that the Review will include examination of the processes through which investors are designated as sophisticated investors and wholesale clients, and whether the consent arrangements are working effectively. The Australian Law Reform Commission (ALRC) has also issued the *Interim Report A Financial Services Legislation ALRC Report 137* (November 2021) in which it also seeks feedback on proposals concerning the wholesale investor definitions (see page 5 for further detail). This consultation closes on 25 February 2022.

Is there evidence of harm?

A key issue that is discussed when calling for a change to the wholesale investor test is whether there is evidence of harm or a market failure. What is the problem that proposals for change are trying to solve?

Global financial crisis

Following the global financial crisis (GFC), Treasury issued a consultation paper¹ seeking feedback on whether the wholesale investor test should change, referencing

a well-publicised case involving local councils² that had invested in complex financial instruments such as collateralised debt obligations (CDOs) sold by Lehman Brothers.

Local councils suffering from large losses as a result of their investments in these high risk and complex financial instruments were held up as an example of a situation where investors should not have been classified as wholesale due to their lack of awareness of the risks

¹ Australian Government, The Treasury, *Wholesale and Retail Clients Future of Financial Advice: Options Paper*, January 2011

² *Lehman Brothers Asia Holdings Limited (in Liquidation) v City of Swan & Ors; Lehman Brothers Holdings Inc v City of Swan & Ors*¹¹



of investing in those products. However, the problems resulting from the investment decisions taken by local councils prior to the GFC were identified as resulting primarily from a failure of governance rather than from problems with the wholesale investor test. Local councils were shown to have no, or deficient proper governance requirements in place to facilitate an appropriate investment decision process. In effect, this meant that relatively low-ranking council employees could commit the council to substantial investments without appropriate and qualified oversight.

The Treasury paper also noted that ‘During the GFC, retail clients’ problems mainly occurred in relation to investments in listed CDOs (which retail clients could access), which suffered substantial losses in market value due to the impact of the GFC on the value of the underlying assets.’

Mayfair

In recent calls for change, reference is made to Mayfair 101 as evidence of the shortcomings of the current wholesale investor test.³

What was made clear in the case⁴ was that ‘red flags’ regarding the operation of the Mayfair group of companies had been raised well before ASIC brought proceedings. That is, concern was raised about the nature of Mayfair’s offer and its mass-marketing to a broad population rather than with the wholesale investor test.

While the view is expressed that it was the wholesale investor test that made investors vulnerable to misleading and deceptive conduct, the false, misleading and deceptive provisions of the Corporations Act apply irrespective of whether a product is offered to retail or wholesale investors. ASIC always had the power to deal with the companies’ misconduct. As ASIC Deputy Chair, Karen Chester stated ‘ASIC’s success in court...demonstrates firms need to do the right thing by their investors, even when they are wholesale investors.’⁵ Categorising a product as being for wholesale investors only, does not allow an issuer to make false, misleading and deceptive statements about that product.

The Mayfair 101 case constitutes an outlier, involving a ‘bad actor’ that abused the wholesale investor test. It is always challenging to see one case being used to justify regulatory reform when the vast majority of those subject

to the particular law are not involved in misconduct. The question needs to be asked if the law should change due to the misconduct of one ‘bad actor’ or whether the focus should be on ASIC’s response to misconduct.

Australian Financial Complaints Authority

The Australian Financial Complaints Authority (AFCA) has discretion to accept complaints from wholesale clients, although it was set up to deal with retail client complaints.

Notice should be made of Treasury’s review of AFCA⁶ which recommends that AFCA should look to more actively exercise its existing discretion to exclude wholesale complaints in appropriate circumstances and that if a complaint is lodged by an apparent wholesale client and AFCA has made sufficient enquiries to rule out that they have been incorrectly or inappropriately classified by the firm, AFCA should have the discretion to exclude the complaint. The report also recommended that AFCA should exclude complaints from sophisticated clients as a matter of course, unless there is evidence that they have been incorrectly or inappropriately classified.

Treasury’s recommendations suggests that it found evidence that the wholesale client complaints lodged with AFCA did not represent investor lack of understanding of the risk of investing in certain financial products only available to wholesale clients. That is, the recommendation suggests that wholesale clients are not being inappropriately classified. The government has accepted the recommendations of the Treasury review.

Financial Services Royal Commission

There was no consideration of wholesale client issues by the Hayne Royal Commission. The topic did not appear to come up during the public hearings and was not mentioned in either the interim or final report.

Lack of evidence of harm

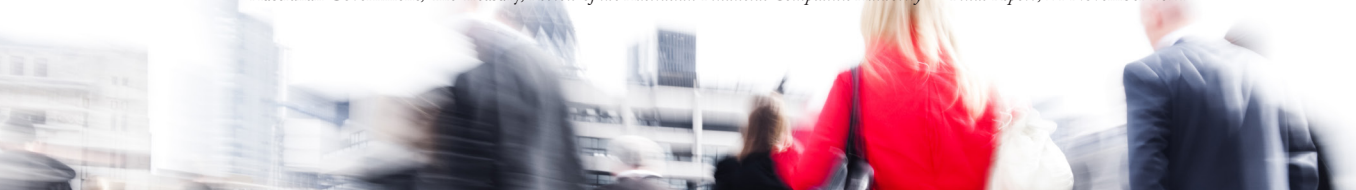
The GFC and its impact on local councils, which was primarily a governance issue, and the Mayfair 101 case, which was the misconduct of one ‘bad actor’ where the regulator already had the enforcement powers available to stop the conduct, are put forward as evidence for why the wholesale investor test needs to change.

³ The Mayfair companies promoted debenture products via their websites and online search platform advertisements to wholesale investors by stating that they were comparable to, and of similar risk profile to, bank term deposits. ASIC took action against the Mayfair companies and the court held the statements made in the advertisements by the Mayfair companies to be false, misleading or deceptive.

⁴ Australian Securities and Investments Commission v Mayfair Wealth Partners Pty Ltd (No 2) [2021] FCA 247

⁵ ASIC media release 21-055MR ‘ASIC succeeds in Court action against Mayfair 101 for misleading and deceptive advertising’, 23 March 2021.

⁶ Australian Government, The Treasury, *Review of the Australian Financial Complaints Authority — Final Report*, 24 November 2021



In light of this, calls for change to the wholesale investor test appear to be a solution looking for a problem. The calls appear to overlook other more pressing and practical issues currently facing the financial advice sector, such as a decline in the number of advisers, the increasing cost of advice and increased regulation adding to the cost of financial advice.

There is also no evidence that there is a market failure in relation to financial advice servicing the higher end of the income and asset distribution, particularly when such individuals have taken deliberate steps to opt out of the retail investor regime. Without evidence of harm or a market failure, are there grounds to introduce law reform?

Arguments in favour of change need to consider how the wholesale investor test is applied in practice, the context of the test and the impact that change would have on investors. These are important considerations when considering whether a policy change is justified.

Calls for change

Calls for change to the wholesale investor test have come from legal academics, members of the legal profession and some parts of the financial advice sector itself. Most of the criticisms focus on the individual wealth test (the monetary threshold test) and in particular the net asset threshold of \$2.5 million, as no longer being satisfactory as a proxy for financial knowledge.

The Financial Services Council (FSC) in its *White Paper on Financial Advice*, issued in October 2021, advocated for the definition of retail and wholesale client to be amended to ensure a greater proportion of financial advice consumers are considered to be retail clients and fall within the consumer protection framework. The FSC recommends:

- the retention of the distinction between wholesale and retail clients as well as an objective test
- increasing the threshold for the assets test from \$2.5 million to \$5 million in 2023 and thereafter indexing it to the Consumer Price Index
- retaining the other tests unchanged including the \$250,000 income threshold
- allowing existing wholesale clients that would be reclassified as retail as a result of the change to remain

wholesale if an election is made within a two-year transition period

- the government to undertake a review, following the completion of the FASEA transition period in 2026, whether an objective threshold is necessary or should be replaced by a provision allowing financial advisers to use their professional judgement to determine who is a wholesale client, as guided by the statutory best interests duty and code of ethics framework.

The paper's proposals are intended to reduce the regulatory burden on financial advisers, but the proposal to change the wholesale investor test could see many more advisers caught up in regulatory red tape.

In November 2021, the ALRC issued its interim report on Financial Services Legislation (ALRC Report 137). The report is open for consultation and invites views on the following aspects of the retail and wholesale client definition:

- what conditions or criteria should be considered in respect of the 'sophisticated investor' exception in s 761GA of the Corporations Act
- whether the asset and income test in section 761G (7) (c) and the product value test in section 761G (7) (a) should be removed
- whether the existing carve outs for general insurance products, superannuation products, RSA products and traditional trustee company services should be amended
- whether the definition of retail client should be amended in some other manner.

Professor Pamela Hanrahan, Professor of Commercial Law and Regulation at UNSW, who advised at the Hayne Royal Commission, has also recommended there is a 'clear and pressing need to update or radically alter the current definitions of retail and wholesale clients', citing Mayfair 101 as an example of the shortcomings of the status quo.⁷ Professor Hanrahan clarified that Mayfair 101 is an example of an investment firm with products seemingly designed for wholesale investors that were mass-marketed to a broader population and that, as was found in the case against Mayfair, this type of mass-marketing is misleading and deceptive if it is targeted at people who lack experience with complex illiquid investments.

Calls to amend the wholesale and retail definitions have also been reported widely in the media. Recent modelling conducted by Australian National University Associate

⁷ Tahn Sharpe, 'Hanrahan: Updating retail/wholesale client definitions "urgent"', 8 June 2021, *Professional Planner*.



Professor Ben Phillips, reported in the *Australian Financial Review* shows that the number of Australians who meet the wholesale investor wealth test has increased from 1.9 per cent of the population in 2002 to more than 16 per cent. The modelling has found 1.09 million households (or 3.25 million individuals) have at least \$2.5 million in assets or annual income exceeding \$250,000. In 2002, when the rule was implemented, just 104,000 households were eligible to be accredited as wholesale by an accountant.⁸

Advocates for change to the test raise the following issues:

- There is not always a positive correlation between wealth and financial literacy. For example, a person may exceed the individual wealth thresholds simply by the receipt of a windfall gain such as an inheritance or as a result of a lucky 'punt', for example, on assets such as cryptocurrency or speculative mining shares.
- With increased earnings, escalating property values, increased superannuation holdings and the effect of inflation, the individual wealth thresholds are becoming increasingly accessible to a range of clients who would not have been considered to be 'wealthy' in 2004.
- There is no mechanism for the periodic review of the product value or individual wealth dollar thresholds.
- Tests based on quantification of wealth exclude clients who have the requisite level of financial literacy, but not the requisite wealth (a good example being a compliant financial adviser).
- The eligibility tests are difficult to apply where assets are jointly owned (which commonly occurs in domestic relationships).
- There is a reluctance by AFSL holders to use the sophisticated investor test because of its subjective nature – with the resulting issues of conflict of interest, uncertainty and room for error in judgment which creates fear of later liability.

A different approach to a call for change has come from investment manager Geoff Wilson of Wilson Asset Management. Given that wealth is not always a proxy for financial literacy, he has stated that attention needs to be focused on the responsibility of the investor to confirm understanding of the financial products and risks in

order to self-select as a wholesale client. He has called for the sophisticated investor test to be abolished so that all consumers can access sharemarket capital raisings while replacing it with a financial literacy test for would-be unit-holders in managed funds.

How is the test applied in practice?

A wholesale investor qualification is not automatic and requires investors to opt in

There is an assumption in much of the recent commentary that a client can be treated as a wholesale client without either their knowledge or requiring their consent or by persuading them to become a wholesale client by virtue of a 'push' from the adviser.

Investors do not automatically become wholesale clients by virtue of their wealth or income; they must actively request this classification by obtaining a certificate from an accountant which must be renewed every two years. Unless they choose to become a wholesale investor and keep their certification up to date, investors who meet the income or asset threshold are subject to the same restrictions and protections as any other retail investor. Wholesale investors therefore take deliberate steps to opt out of the retail investor regime and consciously sign away protections applied to retail investors by seeking the wholesale certification. Importantly, they must obtain a certificate from a qualified accountant who is required to certify that the investor satisfies either or both of the two limbs of the wealth test. Qualified accountants are required to be members of recognised professional accounting bodies to meet the definition. As professionals, they are required to exercise their professional judgement and retain evidence in support of their certification.

The high-net-worth accountant's certificate has to be renewed every two years – it is not a 'set and forget' process. If the certificate expires and is not replaced, the client is no longer a wholesale client under the relevant section of the Corporations Act.

⁸ Aleks Vickovich, 'More than 3 million Aussies are now "sophisticated investors"', 11 October 2021, *Australian Financial Review*.



Is the monetary threshold test the only test applied?

There is more than one test in the legislation.

- **The product test:** the value of the financial product or financial service is greater than \$500,000.
- **Professional investor test:** this includes Australian Financial Services Licensees, Australian Prudential Regulation Authority regulated bodies, trustees of public superannuation funds, persons controlling at least \$10 million and the trustee of a superannuation fund which has net assets of at least \$10 million.
- **Small business test:** the consumer of the financial products or services is a business which is not a small business (that is, a non-manufacturing business with more than 20 employees or a manufacturing business with more than 100 employees).
- **Individual wealth test:** The monetary thresholds are set at \$2.5 million in net assets, or gross income for each of the last two financial years of at least \$250,000 per annum. The rationale behind these monetary thresholds is that investors meeting one of these criteria would be more capable of evaluating the financial products being offered without needing the protections of a regulated disclosure document such as a prospectus or product disclosure statement. ASIC notes that “Generally, people buying securities and other financial products must, under the Corporations Act 2001, be given a regulated disclosure document such as a prospectus or product disclosure statement. However, one of the exemptions in the Act is the offering of financial products to a person (either a natural person or a legal person) who is the subject of a current certificate from a qualified accountant certifying they have a prescribed net asset or gross income level.” The certificate is valid for two years.
- **Sophisticated investor test:** Investors defined as retail who are unable to access wholesale status and that for reasons such as experience or professional training may wish to be treated as wholesale investors to access wholesale investor status and wholesale-only products.

The individual wealth test is the one most popularly used to categorise clients as wholesale. Clients categorised as wholesale clients under this test are also referred to as high net worth (HNW) clients or (confusingly)

sophisticated investors. The confusion between these terms is explained in Appendix A.

A test that is based on an asset or income threshold is easy to apply and transparent to clients. The test is applied side-by-side with the product value test and professional investor test. The tests are well-used and the latter is often relied upon by institutional stockbrokers. Online brokers rely on these ‘black and white’ tests as they are a high volume, no advice business.

Licensees have obligations to certify in writing their reasons for being satisfied that a sophisticated client has previous experience in investing in securities and other financial products. The certification is to show that the client can assess the merits, value; and associated risks of the product and both their own information needs and the adequacy of the information provided by the licensee. The ‘sophisticated investor’ test is subjective and not many firms rely solely on it for this reason.

How are the tests used in practice?

In practice, licensees providing advice take a nuanced approach. They rely on the asset or income threshold test as an objective measure while also taking into account the sophistication and financial knowledge of the client. Licensees understand that a client’s asset level is not always a reliable indicator of financial knowledge or sophistication.

A client who is able to satisfy the asset threshold can be certified as a wholesale client, but this is often just the start of a journey, with the licensee going beyond the Corporations Act definition.

Some licensees have a matrix test that is used to evaluate whether a client who satisfies the asset or income threshold should be treated as wholesale once their investment experience and knowledge is taken into account. Another approach that is taken is to have a sophisticated investor panel that solicits details of the investor’s experience, which includes years of investing, qualifications and occupation and assesses whether they are to be categorised as wholesale. One example of an investor with a high level of financial literacy would be a director of a public company, given that they have a duty to be able to review and understand financial statements.

Licensees have in many instances developed robust processes for onboarding wholesale clients that ensure they are aware of the consequences of no longer being



categorised as retail, with clients required to sign and return an acknowledgement letter. Clients are advised as part of this process that they can ‘opt-in’ to retail if they decide they no longer want to be classified as wholesale. Importantly, under these processes, an adviser cannot simply categorise a client as wholesale — the application must be put before compliance personnel and a control process is applied. The licensee adds the client as a wholesale investor and the adviser cannot interfere in that process. Any queries are referred to compliance.

These processes form part of a licensee’s overall compliance and risk management framework and ensure that decisions about wholesale clients are made by the licensee, not the adviser, and there is appropriate supervision and monitoring of the client’s account and the risks involved.

Wholesale investors still have regulatory protections

Arguments for change do not reference the regulatory controls on the provision of advice to wholesale investors. The provision of ‘wholesale advice’ is not a regulatory ‘free for all’.

Wholesale investors can continue to receive general advice and execution-only services and ask for personal advice under contract with their adviser.

Wholesale investors still have protections under general law, the Market Integrity Rules and other provisions of the Corporations Act, specifically:

- the general obligations under section 912A of the Corporations Act that, amongst other things, require financial services licensees to provide financial services ‘efficiently, honestly and fairly’, manage conflicts of interest, comply with financial services laws and ensure their representatives do so as well and are adequately trained
- the consumer protection provisions of the Corporations Act including those dealing with misleading and deceptive conduct, unconscionable conduct, representations and warranties
- the common law fiduciary duty to act in the best interest of clients.

While the Corporations Act only requires licensees providing advice to retail clients to be a member of the Australian Financial Complaints Authority Scheme (AFCA), the recent *Review of AFCA*⁹ undertaken by Treasury recommended that wholesale investor complaints should continue to be accepted by AFCA where there is evidence that the investors have been incorrectly or inappropriately classified. This provides an important safety net.

As has been previously noted, wholesale clients can always ‘opt back in’ to being categorised as retail if their circumstances change.

Increasing knowledge and education of investors

Investor education has improved significantly since the original monetary thresholds were put in place. Clients are increasingly sophisticated.

Investors have access to more information about financial products and investing than when the test was introduced and can access that information in different ways.

Investors have access to information online via newsletters, chat rooms and investor forums. Listed entities now offer more information on their investor webpages, including webcasts of their AGMs. Regulatory changes resulting from COVID-19 lockdowns meant that listed entities held virtual AGMs enabling many investors to attend these events for the first time.

The Australian Shareholders Association provides investor forums, education days, newsletters and webinars and it and the Australian Investors Association each holds an annual investor conference. Investors are also able to attend investor forums arranged by organisations such as the ASX, which also offers online courses in shares, options and ETFs, as well as the sharemarket game so that investors can learn how the sharemarket works.

There has also been an increase of financial education and advice content on social media apps, although ‘finfluencers’ and money experts alike have urged new investors to be cautious about the financial content available.

⁹ Australian Government, The Treasury, *Review of the Australian Financial Complaints Authority — Final Report*, 24 November 2021



What would be the impact of change?

The client's perspective

According to the *ASX Investor Study 2020* close to nine million adult Australians hold investments outside their superannuation and primary dwelling with more than half investing in direct shares.

It is important to note that support for a change to the asset threshold is not originating from clients. That is, the calls for change are not coming from consumers.

The calls for change also do not consider the benefits that clients would forgo if they were reclassified from wholesale to retail as a result of such a change. Clients ask to be categorised as wholesale, wanting access to the additional investment opportunities available to this cohort. Evidence that licensees are 'pushing' clients into becoming wholesale has not been put forward. Clients would need to be surveyed to assess whether licensees are responding to client demand.

Commentators have argued that the level of securities fraud in Australia is at the lower end of the global experience. Wholesale investors still get the benefit of 'strong regulation, active regulators, vocal institutional investors and a very attentive media that exposes securities fraud long before it becomes endemic'.¹⁰ Evidence that the monetary thresholds are being systematically 'gamed' has not been put forward.

Any change to the wholesale client monetary thresholds would have a significant impact on clients, as many would no longer meet the test should it be amended. Given that clients seek access to wholesale client opportunities, licensees have structured their business to accommodate client demand. Businesses have relied on the existing model and advisers and clients have built their investing strategy on the current model.

In the wholesale advice sector, the relationship between adviser and client is often closely fostered by the adviser and is based on trust developed over a number of years. Changes to the test that re-classify clients may result in them losing access to their adviser of choice or force them to sell down their holdings. Any change would disadvantage a significant cohort of Australian investors who have not been consulted on their views of whether such a change is welcomed by them. With

business models relying on the definitions in structuring their businesses to meet client demand, change will bring disruption and attendant costs associated with implementing change. These impacts would not be uniform across the financial services industry, with some businesses and some clients being much more affected than others.

The financial advice sector has been subject to ongoing significant regulatory reform over a number of years. If the definitions are changed, consideration needs to be given to the impact on some businesses which have already moved away from advice to retail clients, as they could become unviable as the pool of potential clients shrinks. This in turn may exacerbate the decline in availability and affordability of financial advice.

Given that significant additional disruption and costs would be introduced into the system for both clients and licensees when to date no major benefits have been articulated, the rationale for changing the test is not clear, apart from concerns that outlier misconduct such as Mayfair 101 needs to be addressed. While concern is expressed that more and more clients are being provided with financial services without the benefit of the consumer protections that are obligatory for retail clients, as noted earlier, there is no clear evidence of harm.

Mayfair 101 does indeed represent misconduct, but it does not represent the experience of the vast majority of wholesale clients in Australia. An important issue to consider is that the Mayfair 101 case involved the direct issue of unlisted financial product. The clients did not receive advice on the product or apply for the product via their adviser or licensee. Changing the law to respond to the issues arising in the Mayfair case ignores the fact that clients who receive advice from their adviser or who deal through a financial services licensee and who were not the victims of the Mayfair case would be impacted negatively by any such change.

With Mayfair targeting wholesale investors who were avoiding seeking advice, one area that is worth consideration is the marketing of products aimed at wholesale investors. The firm's advertising was found by the Federal Court to have been deceptive and misleading

¹⁰ Hunt, Isuard & Friedlander, 'Arguing the case on investor protection', 24 October 2021, *Australian Financial Review*.



and inaccurately likened the products to term deposits. The advertising sought to divert investors who were interested in term deposits to invest in Mayfair products.

Professor Hanrahan has advised that the restriction of general advertising of wholesale offers should be contemplated, noting that such offers should not be made in the newspaper, particularly without warnings that are routinely required elsewhere, including in the UK.¹¹ Given that Mayfair undertook significant online advertising, including through google 'ad words' designed to divert investors interested in term deposits, restrictions on mass advertising would address concerns that firms are targeting investors avoiding advice and seeking income who meet the individual wealth thresholds.

Any calls for change concerning the wholesale investor test should involve the client's perspective.

Impact on investors outside of Sydney and Melbourne

Those wanting an increase to the \$2.5 million net asset threshold argue that it is easy for clients who own a house in Sydney or Melbourne to satisfy the test, even if they lack financial knowledge. While house prices have increased substantially in Australia's largest cities since the test was implemented and have seen a high rate of growth during the pandemic, house prices in Australia's regional and rural areas or in capital cities such as Perth and Adelaide have not reached the heights of those on the eastern seaboard.¹²

Increasing the threshold will have a disproportionate impact on clients who own real estate in those areas, excluding investors in the regions and a number of capital cities from accessing investment opportunities available to wholesale clients. A Sydney/Melbourne-centric view of Australian investors is narrow and does not take into account the perspectives of those living outside of these cities.

Clients in regional and rural areas and other capital cities would need to be consulted as to whether they support a change to the wholesale investor test.

Impact on other provisions of the Corporations Act

The wholesale client definition in Chapter 7 of the Corporations Act mirrors definitional provisions in

Chapter 6. Currently, offers of securities do not need disclosure to clients meeting the net asset or income threshold in section 708 (8) of the Corporations Act. Clients meeting the same net asset or gross income test in section 761 G (7) (c) can be classified as a wholesale client for the purposes of the provision of a financial product or service. This enables a client who has been classified as wholesale for the purposes of a capital raising, for example, to be classified as wholesale for the purposes of buying and selling financial products.

Inconsistency in definitions between chapters 6 and 7 of the Corporations Act would result in clients who are classified as wholesale for one purpose being ineligible to be treated as wholesale for another. This would be unworkable for stockbrokers and investment advisers as well as being confusing and frustrating for their clients.

Is there consumer benefit from proposed changes?

The main call for change relates to increasing the monetary thresholds for the individual wealth test.

Increasing the thresholds of the HNW investor test retains the current difficulties attached to the framework for assessing if an investor is retail or wholesale, as such an approach is still based on access to a level of wealth holdings, regardless of the sophistication of the investor. Given that wealth is not always an accurate proxy for financial literacy, introducing a higher monetary threshold continues the use of wealth holdings as the definitional threshold, despite the reality that access to wealth does not of itself provide for sophisticated investment decisions.

Changing the monetary threshold does not take into account the fact that many firms don't merely focus on a monetary threshold when deciding whether a client should be categorised as a wholesale investor, but also take into account qualitative measures.

Another change proposed is to apply indexing to the monetary thresholds. Applying an index to the asset threshold increases complexity and reduces transparency. Indexing adds uncertainty to determining whether a client meets the requirements or not and would not take into account financial market corrections.

There have been suggestions such as excluding the family home when determining if an investor meets the

¹¹ Tahn Sharpe, 'Calls mount for sophisticated investor rule review', 17 February 2020, *Professional Planner*

¹² The *Quarterly House Price Report* from online property marketplace, Domain released in January 2021 showed that Australian median house prices across all capital cities have increased to over the \$1 million mark.



monetary thresholds. Excluding the family home would simply advantage those clients who do not own a home and have invested in other assets while disadvantaging those who have decided to place their wealth in their family home. The regulatory focus should not be on the manner in which clients choose to invest their wealth. Furthermore, excluding the family home is likely to exclude a number of clients who are currently classified as wholesale and wish to remain categorised as such.

Despite investors not pushing for the test to be changed, a change to the test would potentially result in clients who were previously categorised as wholesale investors failing to meet the new definition, placing limits on their investment choice and causing unfairness. It may also close down access to investment opportunities and the individual market for capital.

Licensees have aligned their business model to the current regulatory framework, including the wholesale client definitions. Advisers who have adopted a wholesale-client-only business model are not required to have satisfied the educational and exam requirements that allows them to provide advice to retail clients. They would therefore find themselves treated as new entrants, subject not only to the education and exam requirements but also the Professional Year requirements and without a livelihood.

Furthermore, a change to the wholesale client definition will inevitably result in clients that were previously defined as wholesale being reclassified as retail. A wholesale-client-only adviser will be unable to continue to provide advice to those reclassified clients, essentially resulting in those retail clients losing their adviser. This may not be such a significant issue if retail client adviser numbers were increasing. Unfortunately, the reverse is the case. As of 3 December 2021, the net loss of advisers on the Financial Adviser Register for the 2021 year had surpassed 2,000 with the number of advisers at 18,574. In comparison, in 2018 there were 28,353 Financial Advisers.¹³ One outcome of the combination of a change in the wholesale client definition and the significant decline in the number of retail client advisers would be that reclassified clients would lose access to personal advice. At a time when the government, regulators and the financial advice industry concur that access to financial advice is now more difficult and there is a need

to work together to improve access, cutting a cohort of clients adrift would be counter-productive.

Consideration needs to be given as to whether there is a desire to remove all decision-making responsibility from investors.

Conclusion

This paper questions whether there has been a sufficient identification of harm to investors in recent calls to justify amendment of the wholesale investor test and whether the significant disruption to clients and advisers (and their businesses) that would arise from any change to the definitions can be justified in light of the impact it would have on access to and affordability of advice.

A key question is whether reference to outlier misconduct should be utilised to disrupt significant numbers of clients' investment strategies and licensees' business models. Misconduct needs to be investigated and enforcement action taken — ASIC already has the powers to do this. Yet recent calls for change take the view that a range of Australian investors should be excluded from accessing investment opportunities due to outlier misconduct, or the potential for outlier misconduct.

Another key question is whether the voice of the client has been sought. Before embarking on another round of regulatory reform, it would be appropriate to survey wholesale clients, qualitatively and quantitatively, to assess their views on whether they have concerns that they:

- have been inappropriately classified
- do not understand the risks of the financial products in which they invest
- are happy to be excluded from investing in certain financial products.

This paper has been issued to inform the current debate on whether the wholesale investor test should be changed, particularly in light of the two consultations taking place that are examining this issue. It raises a series of questions and it is hoped that all those interested in this issue will consider them.

¹³ 'Over 2k advisers have exited the industry this year', 3 December 2021, *Independent Financial Adviser*.



Appendix

Background

A distinction between retail and wholesale clients was inserted into the Corporations Act by the *Financial Services Reform Act 2001* developed in response to the recommendations of the Wallis Inquiry released in March 1997.

Motivation

The main motivation for drawing the distinction between retail and wholesale clients was to identify those considered in need of regulatory protection, as well as the desire to allow certain clients to participate in wholesale markets which tend to trade more complex products. Consumer protection provisions would only apply to retail clients as it was recognised that wholesale clients did not require the same level of protection, as they are better informed and better able to assess the risks involved in financial transactions. Wholesale investors are also better able to fend for themselves financially if a dispute arises or sustain the risk of loss.

Insurance and superannuation were treated differently, but investors in other financial products could be treated as wholesale clients if they satisfy certain tests: product value, professional investors; small businesses; and individual wealth.

The tests

- **The product test:** the value of the financial product or financial service is greater than \$500,000.
- **Professional investor test:** this includes Australian Financial Services Licensees, Australian Prudential Regulation Authority regulated bodies, trustees of public superannuation funds, persons controlling at least \$10 million and the trustee of a superannuation fund which has net assets of at least \$10 million.
- **Small business test:** the consumer of the financial products or services is a business which is not a small business (that is, a non-manufacturing business with more than 20 employees or a manufacturing business with more than 100 employees).

- **Individual wealth test:** The monetary thresholds are set at \$2.5 million in net assets, or gross income for each of the last two financial years of at least \$250,000 per annum. The rationale behind these monetary thresholds is that investors meeting one of these criteria would be more capable of evaluating the financial products being offered without needing the protections of a regulated disclosure document such as a prospectus or product disclosure statement. ASIC notes that “Generally, people buying securities and other financial products must, under the Corporations Act 2001, be given a regulated disclosure document such as a prospectus or product disclosure statement. However, one of the exemptions in the Act is the offering of financial products to a person (either a natural person or a legal person) who is the subject of a current certificate from a qualified accountant certifying they have a prescribed net asset or gross income level.” The certificate is valid for two years.

Insurance, superannuation, retirement savings account products and traditional trustee company services are treated differently. Where a financial service relates to a superannuation product, a trustee of a self-managed superannuation fund will be classified as a retail client unless the fund holds net assets of at least \$10 million at the time the service is provided.

The individual wealth test is the one most popularly used to categorise clients as wholesale. Clients categorised as wholesale clients under this test are also referred to as high net worth clients or (confusingly) sophisticated investors.

Sophisticated investor test

In 2007, a definition of ‘sophisticated investor’ was introduced to Chapter 7 of the Corporations Act. This new section mirrored section 708 (10) and aimed to apply the same tests that applied to securities and debentures in Chapter 6D of the Corporations Act, thus providing a more consistent regulatory approach to disclosure across a larger range of financial products. The class of sophisticated investors was intended to be



a subset of wholesale clients. Although the existing tests had adequately addressed the circumstances of many investors, Parliament considered that there were some investors defined as retail who were unable to access wholesale status and that for reasons such as experience or professional training, these investors may wish to be treated as wholesale investors to access wholesale investor status and wholesale-only products. Sophisticated investors also are exempt from having to be provided with a regulated disclosure document.

Licensees have obligations to certify in writing their reasons for being satisfied that a sophisticated client has previous experience in investing in securities and other financial products. The certification is to show that the client can assess the merits, value; and associated risks of the product and both their own information needs and the adequacy of the information provided by the licensee.

Sophisticated investors are also referred to as experienced investors.

Confusion

In much commentary, the terms ‘high net worth’ and ‘sophisticated investor’ are used interchangeably, even though they are referring to different investor categories.

Confusingly:

- section 708 (8) of the Corporations Act (Chapter 6) defines high net worth investors (those who satisfy the product test or the net assets and/or gross income tests) as ‘sophisticated investors’ in its heading
- section 761GA of the Corporations Act (Chapter 7) defines ‘sophisticated investors’ as those who satisfy the experience test.

As noted, ‘wholesale clients’ refer to all clients who are not considered to be retail clients. In this paper ‘high net worth investor’ is a reference to those who satisfy the net assets and/or gross income tests in sections 708 (8) and 761G (7) and ‘sophisticated investor’ is a reference to those investors who satisfy the experience test in sections 708 (10) and 761GA.

2011 review of the individual wealth test

Treasury undertook a consultation in January 2011 as part of the Future of Financial Advice reforms on various options for the criteria under which a client was considered to be wholesale or retail in the context of receipt of financial advice.¹⁴ There was concern that during the global financial crisis many investors suffered losses, because monetary thresholds do not accurately measure the financial literacy of investors and can fail to protect wealthy investors with limited investment experience.

Options presented in the consultation paper included:

- indexing the wealth tests so that they remain relevant over time
- excluding the client’s primary residence (family home) and superannuation from the net wealth threshold
- changing the process by which clients are deemed to be wholesale to require specific acknowledgement from the client that they will be classed as a wholesale client and they will not receive the benefit of protections provided to retail clients
- repealing the ‘sophisticated investor’ test on the basis that it is scarcely used and is subjective
- removing the distinction between wholesale and retail clients, thus ensuring high levels of investor protection
- eliminating the wealth thresholds and introducing a ‘sophisticated investor’ test as the sole way to distinguish between wholesale and retail clients.

The consultation paper noted that “Arguably the approach to defining ‘sophisticated investors’ is a more appropriate way to distinguish whether they are able to deal with complex financial products than a simple wealth test. Although, the subjective nature of the ‘sophisticated investor’ test places the onus on the licensee, creates less certainty and makes it difficult to determine if a [accountant’s] certificate was properly issued.”¹⁵

There was no consensus in the 30 submissions Treasury received in response to the consultation. Some responses noted that the distinction between retail and wholesale clients permeated the whole fabric of financial services

¹⁴ Australian Government, The Treasury, *Wholesale and Retail Clients Future of Financial Advice: Options Paper*, January 2011

¹⁵ Ibid



regulation and consequently the way the financial services industry is structured and there was no evidence to suggest that further increases in the monetary thresholds would continue to correlate with financial literacy and experience. Others called for an increase in and indexing of the monetary thresholds and the exclusion of the family home from the assets test.

In its response to the consultation, SIAA queried the lack of a clear rationale behind the proposals and raised concerns about the possible detrimental effects of the proposals on capital raising, particularly in the small and mid-cap sectors.

The government took no action in response to the consultation and the individual wealth test remained unchanged.

International comparisons

Australia is not an outlier when it comes to the threshold for wholesale investors. Almost all major jurisdictions set their monetary wholesale investor thresholds at a lower level, although some exclude assets like the family home from the calculation.

United States of America

The United States of America has definitions similar to the Australian definition of wholesale investors. The wealth threshold for a natural person is set at an individual net worth or joint net worth with that person's spouse exceeding US\$1 million. The value of a natural person's family home is excluded from the calculation. The income test is income exceeding US\$200,00 in each of the two most recent years or joint income with a spouse exceeding US\$300,000 for those years and a reasonable expectation of the same income level in the current year.

United Kingdom

In the UK, investors can self-certify as a High Net Worth investor or a Sophisticated Investor. The "High Net Worth" investor test is net assets (excluding any primary residence, pensions and contract of insurance) of £250,000 or more, or an income threshold of £100,000 per annum.

A Sophisticated Investor is one that self-certifies as satisfying one of the following conditions:

- been a director of a company turning over at least £1 million within the last two years
- made more than one investment in an unlisted company in the last two years
- been a member of a network or syndicate of business angels for at least six months
- worked in the past two years in a professional capacity in the private equity sector or in the provision of finance for small and medium enterprises.

Hong Kong

Hong Kong has a single asset test of securities, cash and/or cash equivalents portfolio of roughly \$US1 million.

Singapore

Singapore has the "Accredited Investor" classification for individuals with a net assets test of an amount exceeding SG\$2 million (of which the net value of the investor's primary place of residence can only contribute up to SG\$1 million) or an annual income test of not less than SG\$300,000.

New Zealand

New Zealand has a net assets test of NZ \$5 million. It has no investor income threshold test.

Investors can self-certify to be an 'eligible investor' in relation to a particular transaction if they have sufficient experience in acquiring or disposing of financial products to be able to assess:

- the merits of the transaction
- their own information needs in relation to the transaction, and
- the adequacy of the information provided by any person involved in the transaction.

That certification requires a financial adviser, a qualified statutory accountant, or a lawyer to sign the certification stating they are satisfied the investor has been sufficiently advised of the consequences of self-certification and have no other reason to consider the self-certification is incorrect or that further information or investigation is required. ■





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