Inquiry by the Commonwealth Parliament
Wholesale Client Test for Financial Products & Services
Consultation Response by
Angas Securities Limited AFS License 232479

1. Angas Securities contends that product value thresholds should be abolished altogether or increased to a serious entry level such as $20 million. Registered Managed Investment Schemes and other compliant and licensed operatives can provide protections for retail investors. Wholesale investor "carve outs" provides scope for unregistered and often disreputable operators to dilute these protections or eliminate them altogether. As the Full Court of the Federal Court of Australia said in **Mayfair Wealth Partners Pty Ltd v Australian Securities and Investments Commission** [2022] FCAFC170 at paragraphs 82 and 83:

   "The appellants repeatedly elide the concept of a "wholesale investor" with a "sophisticated investor" in an ordinary sense of a financially sophisticated person. The elision is invalid. The definition of a "wholesale investor" used in respect of the Mayfair products is only that the person:

   1) wishes to invest $500,000 or more; or
   2) has net assets of $2.5 million or above; or
   3) has a gross income of $250,000 per annum or above for the last two years.

   It cannot be assumed that all people who meet one of those criteria have knowledge or experience in respect of financial products. Nor can it be assumed that that class of person did not include numerous persons who were dependent on the accuracy of the marketing material the appellants chose to promulgate."

2. Angas Securities contends to the Inquiry that:

   2.1. Net assets should be increased to a minimum threshold of $5 million with certain assets excluded (see below).

   2.2. Gross income should be increased to a minimum threshold of $2.5 million per annum for 2 years. There is a fallacy in equating wealth (however gained) with financial acumen. Successful athletes, actors and musicians are well known examples of wealthy individuals who might have poor investment acumen. The protections of retail investors ought to be extended to them, not carved out.

   2.3. The family home should be excluded from the calculation of net assets (but not the net equity in any recreational or investment real estate). House prices in Australia now show that a person who buys an ordinary house who pays off the mortgage over term can be left with an unencumbered asset worth $2.5 million without gaining any enhanced understanding of investment principles or risk.

   2.4. Superannuation ought to be excluded. It is already a special class of asset in that it is not available to the trustee of a bankrupt estate. As with rising house prices, accumulating superannuation does not promote any concomitant increase in financial literacy.

   2.5. Consent forms to establish net thresholds can be manipulated easily by unscrupulous product purveyors who prey upon wealthy citizens who lack genuine financial

sophistication. Any consent form should be witnessed by a solicitor who must certify independence from the financial product issuer and that the so-called wholesale investor has had loss of rights and protections explained to him or her and appears to understand them.

3. The Corporations Act was recently amended to introduce Design and Distribution Obligations to introduce suitable restrictions. Legitimate schemes will flourish in a fair market with a confident investment environment. There are still investment outfits who slip through the cracks. So-called registered schemes exist which are run with minimum compliance generally and no Target Market Determinations in particular.

4. Changes should be made to the procedure for registration of Managed Investment Schemes in conjunction with increasing wholesale client thresholds and enforcing appropriate product design and distribution. The practice of “renting” Responsible Entities from unrelated companies who do not manage the scheme ought to be prohibited and actively enforced. The current scheme legislation has replaced the former system of duality with responsibilities shared by a trust and a manager. Now there is a single entity directly responsible to scheme members for the scheme’s operation. There are many small to medium sized mortgage trusts operating in Australia with the superseded model effectively in place. A fund manager contracts with a Responsible Entity “for hire” and then accepts funds from the public through a number of contrivances including the wholesale carve out. Such operations follow the Mayfair 101 path. Investor confidence in the Australian investment is lost.

   Registration should be refused if the operation is not a licensed and fully compliant single entity with an entire operation directly responsible to the scheme’s members for the scheme’s operation including holding appropriate insurance cover. Parliament did not intend that the RE and management functions be split when it enacted the Managed Investments Scheme legislation in 1999.. It is not in the interest of investors (often self funded retirees nor the Australian Financial System overall) for a specialist entity in Sydney to be Responsible Entity for an operating business in Adelaide with which the Sydney entity has no causal relationship; either with the investors or the investments. That is the position now.

   Such manipulation of the Authorised Representative role needs to be addressed. It should be restricted as intended to enterprises where the Responsible Entity conducts an actual business which authorizes other entities to represent it. The current fiction of small outfits with a paucity of resources paying an interstate company to act as its Responsible Entity is a loophole that should be closed. Very often these dubiously compliant fund managers then use the low wholesale client threshold to manage the savings of individual citizens with limited financial or investment acumen.

5. Compensation arrangements for Australian Financial Services Licence holders are primarily dealt with in section 912B of the Corporations Act and Reg 7.6.02AAA Corporations Regulations. ASIC's RG 126 deals with "Compensation and Insurance arrangements for AFS licensees" and summarizes legal and regulatory requirements. Professional Indemnity cover must be "adequate". Table 4 to RG 126.54 suggests cover should be approximately equal to actual or expected revenue (up to $20 million).

   However, Responsible Entities are subject to the specific Professional Indemnity licence requirements imposed by PF 209. This requires Responsible Entities to "maintain an insurance policy covering professional indemnity and fraud by officers that...covers claims amounting in aggregate to......$5 million". This is nearly double the level of cover suggested by Table 4 to RG 126. However, PF 209 is said to be subject to "individual circumstances”. Surveillance conducted by ASIC reported to the market that there is a deficit in compliance amongst some Responsible Entities. This exposes investors to risk and unequal treatment.

   The state of the Professional Indemnity insurance market in Australia for the financial sector is

shrinking. AIG, one of this nation's last remaining Pl insurers (for investment management and financial planning) withdrew from the Australian Pl market in September 2022. AIG has stopped writing Pl business for AFS Licensees. This is a major problem for many Responsible Entities for whom AIG has been the primary Pl insurer for many years. The problem is accentuated for smaller Responsible Entities subject to the PF209 requirements where those requirements comfortably exceed the requirements otherwise suggested by RG126.54.

Apart from industry behemoths, complying Responsible Entities are now compelled to seek their requisite Pl cover in overseas markets, despite it being doubtful that the constitutional power to compel such an outcome exists. There are underwriting agents operating in Australia on behalf of foreign principals - but it is not evident that any will take on increased capacity sufficient to cover AIG's current market share. The current requirements restrict competition between compliant fund managers.

There is little or no tension in premium pricing unless insurance is sought offshore. The lack of competition and the compulsory nature of the Pl cover leaves Responsible Entities open to premium gouging, even if cover is offered. The overseas Pl market seems to have a general appetite for writing Australian financial institutions risks and has shown to be more competitive.

The looming crisis in Australia has received widespread coverage in various industry publications. Although most Responsible Entities do NOT provide financial advice, the history of Pl insurance for financial advisers is none the less instructive. Financial planners and other licensed advisers are broadly grouped in the same sector as Responsible Entities, with advisers seeking cover from the same insurers. According to an article by Laura Dew writing for Money Management on 22 June 2022 (https://www.moneymanagement.com.au/news/financial-planning/consumers- risk-licensees-opt-cheaper-pi) almost every single licensed adviser has experienced year on year increases in its Pl insurance premium regardless of claims history.

Because of the factors discussed, securing "adequate" cover in Australia for Responsible Entities conforming to RG 126.54 is very tough (and unnecessarily expensive} but is much easier than securing the $5 million cover currently mandated by PF 209. In our submission, Pl cover held for $2.5 million is "adequate" for all Responsible Entities. PF209 should fall into line as to the amount of Pl cover required by provided that cover is adequate if it conforms to RG 126.54

About Angas Securities Limited: Angas Securities is in its 25th year of trading. The company is Responsible Entity for three Managed Investment Schemes comprising a total of 3,000 Australian investors. Angas Securities is fully licensed by ASIC and does not rely on the Wholesale Investor Tests. Full consumer protection mandated by law is extended to each of its 3,000 investors.

ANGAS SECURITIES LIMITED

ACN 091 942 728; AFSL 232479

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