

Parliamentary Joint Inquiry into wholesale investor and wholesale client tests

Tech Council of Australia Submission

May 2024



1. Introduction

Thank you for the opportunity to make a submission to this important inquiry in relation to the wholesale investor and wholesale client tests.

The TCA is Australia's peak industry body for the tech sector. The tech sector is a key pillar of the Australian economy, and Australia's seventh largest employing sector. The TCA represents a diverse cross-section of Australia's tech sector, including startups, scale-ups and venture capital firms.

Australia's tech sector has matured significantly over the last decade, supported by a relatively strong economy and favourable government policy settings, which includes the wholesale investor test.

We have not only seen an acceleration in the number of startups in Australia, we have also demonstrated the ability to scale many of these startups into globally successful medium and larger-sized firms.

Investment by wholesale investors into the tech ecosystem, particularly into tech startups, is vital. Without wholesale investors, or with fewer eligible investors, there would be a material impact on the Australian tech investment landscape, which would in-turn impact the number and diversity of startups founded in Australia. Substantial increases to asset and income thresholds would also have a disproportionate impact on women and young investors, excluding them from good tech investment opportunities.

We make three recommendations with respect to the wholesale investor test:

Recommendation 1: create additional alternative pathways for investors to qualify as wholesale investors.

There are two mechanisms that should be explored as potential additional pathways to an objective determination of whether an investor should qualify as a wholesale investor, based on their knowledge, experience or skills. These include:

- Mechanism 1: Utilising existing learning courses to accredit investors under an educational pathway, and
- Mechanism 2: Recognising the professional training or experience of an investor.

Recommendation 2: make changes to the existing experienced (sophisticated) investor test to allow for a more objective determination of a potential investor's suitability.

The existing experienced (sophisticated) investor test for assessing whether someone is a experienced investor could be improved by the introduction of objective criteria that would give AFS License holders clearer guidance by which to assess whether someone is an experienced investor, and therefore has the knowledge or capability to invest.

Recommendation 3: if any changes are made to the asset or income thresholds for the wholesale investor test, they must be targeted and grandfathered.

While we caution against a blunt increase to the existing income or asset thresholds, if the Government is inclined to make changes, they should consider more targeted reform options focused on the asset threshold, noting increasing property prices have largely been the reason for the broader growth in investor eligibility. A simpler change, with fewer unintended

consequences to startups in Australia, could involve simply removing the family home from the assets test.

Any changes must also be grandfathered. If changes are applied to existing investments, this would create an immense amount of cost and complexity for investment funds, individual investors and startups and would be detrimental to the tech investment landscape in Australia.

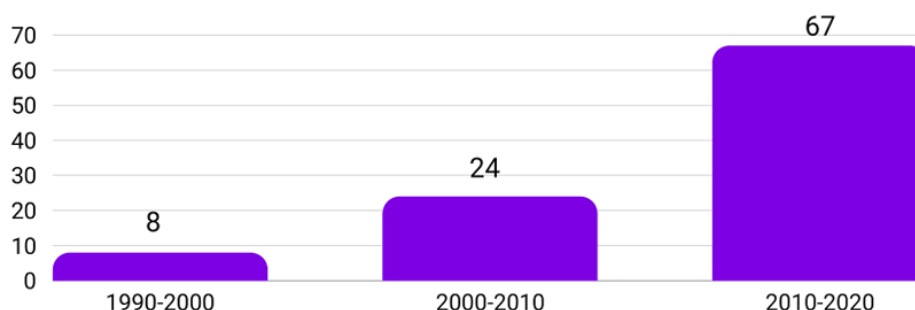
Importantly, the tech sector would not support increases to thresholds that are not accompanied by broader reforms to introduce additional alternative pathways, as outlined in recommendations 1 and 2.

2. Australia has a growing tech sector that requires further investment to thrive

Australia now has over 100 tech companies valued at over \$100 million, with most of these founded over the last decade, and at least 20 unicorn tech firms (valued at over \$1 billion).¹ This includes companies such as Atlassian, Canva, SafetyCulture, WiseTech Global, Culture Amp, Technology One, Afterpay, REA Group, Carsales, Airwallex, Go1, Employment Hero and more. We have also attracted some of the largest global tech companies to our shores, such as Google, Microsoft, IBM, AWS, Adobe and Salesforce, with many of these companies providing infrastructure and services that have supported the growth of Australian tech companies.

Figure 1: High value Australian tech companies by year of founding²

Number of companies valued >\$100m



Sydney is now ranked as one of the top 20 startup ecosystems in the world³ and Melbourne is not far behind. We are also seeing tech hotspots emerge across other parts of the country in every state and territory and not just in our cities but also in our regions. CSIRO Data61 and the Tech Council have identified 96 tech clusters in total across Australia.⁴

Australia has been particularly strong in developing global tech companies in areas like B2B and B2C software, fintech, and life sciences. We also have capabilities and potential in other

¹ [The state of Australia's tech ecosystem, Tech Council of Australia](#)

² [The state of Australia's tech ecosystem, Tech Council of Australia](#)

³ [Startup Genome, Global Startup Ecosystem Ranking 2023](#)

⁴ [The geography of Australia's digital industries, CSIRO and the Tech Council of Australia](#)

tech segments that stretch beyond these areas, such as quantum, robotics, drones, geospatial/surveillance tech, AI, cyber security, cloud and datacentres and energy tech.⁵

Importantly, the significant growth we have seen in Australia's tech sector since 2010 has coincided with a period of rapid growth in venture capital in Australia. Access to capital is one of the most significant factors for the growth of our startup and scaleup sector. The growth of capital in Australia has been assisted by favourable policy settings such as Early Stage Venture Capital Limited Partnerships (ESVCLPs) and early-stage innovation company tax incentives, which rely on wholesale investor definitions.

While the environment for tech investment has materially improved in Australia, it is still not as large or mature as international markets such as the US, UK, Singapore or Israel,⁶ and we have seen a reduction in tech investment over the last two years due to economic conditions.⁷

Notwithstanding our successes, Australia's direct tech sector is also still relatively small as a share of our economy compared to other markets such as the US, UK and Canada, contributing approximately 3.8% of GDP compared to the US' 10.2%, UK's 8.1% and Canada's 6.8%. Our market can also present challenges for startups seeking to scale compared to more mature markets like the US, where there are more significant investment and customer opportunities.

If Australia wants to position itself as a digital economy leader, including in emerging technologies like AI, cyber and quantum, then we need to continue improving the investment environment to drive further private investment and growth to Australia's tech ecosystem.

Investment into tech also offers the opportunity for significant returns for investors. Our research shows that the Australian VC and PE return over 5-years, 10-years and 20-years was higher than the ASX300 and the ASX Small Ords over the same periods. These are investment opportunities that should be inclusive and available to a greater diversity of Australians with the appropriate experience/capability, not limited only to very high-net wealth individuals.

3. Impact of raising the threshold for the wholesale client test

We understand some third parties have called for Government to increase the wholesale investor net asset and income thresholds in response to concerns over consumer protection, as part of its review of the regulatory framework for Managed Investment Schemes. Some of the proposals put forward would index the thresholds to account for inflation over the last two decades, which, if implemented, could result in a net asset test of \$4.5 million (up from \$2.5 million) and an income test of \$450,000 (up from \$250,000). The impact of these potential changes on startups and tech investment would be material.

The vast majority of Australian venture capital funds (including ESVCLPs) require investors to be wholesale investors. A blunt increase to the wholesale investor income or asset thresholds would have an outsized negative impact on the tech sector by reducing the flow of investment by individuals into these funds and subsequently the flow of capital into Australia's start-up ecosystem.

⁵ [Turning Australia into a regional tech hub Report 2022, Tech Council of Australia and McKinsey](#)

⁶ [Shots on Goal July 2022, Tech Council of Australia](#)

⁷ [Cut Through Ventures / Folklore Ventures 2023, The State of Australian Startup Funding 2022, Techboard, Australian startup funding in review 2023](#)

As a second order impact, wholesale investors are eligible for tax breaks under the Early Stage Investment Company (ESIC) scheme, which was introduced in 2016 with the goal of increasing angel investor activity in the economy. “Angel” investors are individuals who invest directly into a start-up company. Angel investors falling under the changed thresholds will no longer be eligible for these tax breaks, likely impacting the flow of capital into early-stage companies. In addition, by raising the thresholds for those able to avail themselves of the tax breaks, there will be an entrenchment of those tax breaks to those on higher incomes/with larger net asset balances.

Impact on startups

The impact would be felt most acutely on very early-stage startups. Venture Capital Funds (ESVCLPs in particular) and angel investors typically provide early-stage funding, before there have been any other funding rounds. As a result, startups would have fewer sources of funding available to them in the very early stages of their lifespan, when they need it most.

Startmate, a startup accelerator, estimates that over 95% of their investors qualify as wholesale investors based on the current income or net asset test, and over 300 investors across their funds would be deemed ineligible under ASIC’s proposed new definition of a wholesale investor. This represents ~80% of all investors in their funds and approximately 25% of committed capital.

A major venture capital fund estimates that across all of their funds, over 90% of their non-institutional investors qualify as wholesale investors based on the income or asset test as certified by their accountant or via the product value test. About 60% of the limited partner investors would become ineligible under the proposed changes, with these investors having committed \$84 million of capital, representing approximately 3% of total committed capital in those funds.

Based on wholesale investor data from Aussie Angels (a platform that supports early-stage tech investing via syndicates and funds), approximately 7 out of 10 investors who qualify do so based on income not assets. An income threshold of \$450,000 would impact a significant portion of these investors, noting recent research has shown that more than half of angel investors earn less than \$400,000 per year.⁸

The data from the recent State of Australian Startup Funding Report 2023⁹ indicates that for angel investors, only about 14% make more than \$400,000 in annual income.

⁸ Cut Through Ventures / Folklore Ventures 2023, *The State of Australian Startup Funding 2022*

⁹ [The State of Australian Startup Funding 2023 \(australianstartupfunding.com\)](http://The State of Australian Startup Funding 2023 (australianstartupfunding.com))

Figure 2: Angel investors: investor status and annual income¹⁰



At least 10 percent of publicly announced and/or directly reported private investments into Australian startups and tech companies captured by Techboard between 2017 and 2023 involved investment from angel investment groups (noting that the proportion of total deals invested in by angel investors is estimated to be significantly higher than this).¹¹

Impacts on investors

In the long-term, the proposed changes are not only likely to result in reducing the growth rate for tech investment in Australia, they would also present individual investors with fewer and worse options for investing.

This is particularly the case for women and younger Australians, who are already under-represented in angel investment (women represent 30% of angel investors and Australians under the age of 35 represent 25%).¹² We consider that one of the key benefits of having a diversity of angel investors is that they drive investment in diverse and high-quality startups and founders.

Individual wholesale investors are also particularly important for startups, who may not yet be able to attract investment from institutional investors and rely heavily on investment from individual wholesale investors.

As outlined above, Startmate estimates that individual wholesale clients make up more than 95% of their total client base, and contribute approximately 75% of total capital across Startmate's funds. Approximately 75% of the companies that Startmate funds invest in have no previous institutional funding. The companies Startmate sees are predominantly raising family and friends rounds at the pre-accelerator stage, and these investors would all be individual investors rather than institutions. Startmate has invested in over 230 startups over the past decade with 95% of their investors being individual wholesale clients. This investor base is particularly important to early-stage funding.

¹⁰ Image from: [The State of Australian Startup Funding 2023 \(australianstartupfunding.com\)](http://The State of Australian Startup Funding 2023 (australianstartupfunding.com))

¹¹ A large portion of private investment into startups goes unannounced. It is estimated that the rate (as a proportion of total investment) at which deals are publicly announced increases with the size of the investment and the later the stage of the investment round, meaning earlier stage investments are more likely to be under-reported.

¹² Cut Through Ventures / Folklore Ventures 2023, *The State of Australian Startup Funding 2022*

International experience

Recent changes to the sophisticated investor test in the UK are highly relevant to Government considering the wholesale investor test and any potential changes in Australia.

In 2023, the UK Government decided to raise the thresholds for high net worth individuals from income of at least £100,000 to £170,000 or net assets from at least £250,000 to £430,000. This came into effect on 31 January 2024.¹³ Following the announcement of the changes, significant concerns were raised about the impact of these changes on the ability of startups to obtain investment and raise finance through small-scale investors.

In March 2024, the UK Government decided to reverse the changes that had been made back to the original income and assets thresholds, which came into effect on 27 March 2024.

The existing experienced (sophisticated) investor test is not a sufficient alternative pathway to investment

We acknowledge that income and asset thresholds are not the only pathway to be recognised as a wholesale investor. However, while there is an existing test to recognise experienced investors, this test would not address the issues we have identified above.

The experienced (sophisticated) investor test places all the onus on the AFSL holder to determine subjectively whether someone meets the test or not, and all the legal risk is placed on the licensee if there is ultimately a dispute about that assessment. In addition, there is little guidance about how an AFSL holder should make the determination.

As a licensee, the AFSL holder must satisfy themselves that the prospective investor has enough previous experience to assess the merits of the offer, the value of the securities, the risks of the investment, their own information needs and the adequacy of the information.

This requires the license holder to form a subjective view on the prospective investor's thinking, mindset and needs. Given the highly regulated nature of investing and penalties for non-compliance, license holders are reluctant to take the risk. In particular, it is difficult to implement at any scale given the significant resources that would need to be deployed to make this assessment on a case-by-case basis. As a result, VC funds do not typically accept prospective investors on the basis of the experienced (sophisticated) investor test. The test is ineffective for the purpose for which it was created.

A clear and more objective framework in this regard will allow more license holders to recognise potential investors' knowledge and experience.

4. Recommendations

We make three recommendations that would protect and encourage investment into early-stage tech startups.

Recommendation 1: create additional alternative pathways for investors to qualify as wholesale investors.

The current approach focuses on whether someone has wealth, which does not necessarily mean that someone has the knowledge or experience to understand and take on the

¹³ [Herbert Smith Freehills, Further changes to UK high net worth individual and sophisticated investor exemptions, 22 March 2024](#)

different types of investment opportunities available to wholesale investors (including investments in VC funds). At the same time, many investors who fall below the income and assets thresholds do have that knowledge or experience. Regardless of any changes to the income or asset threshold for wholesale investors, we recommend creating additional, clearer, more objective educational pathways for determining whether an individual has the knowledge or capability to invest.

There are two mechanisms that should be explored as potential pathways to an objective determination of whether an investor should qualify as a wholesale investor, based on their knowledge, experience or skills. These include:

- Mechanism 1: Utilising existing learning courses to accredit investors under an educational pathway
- Mechanism 2: Recognising the professional training or experience of an investor.

Mechanism 1 – utilising existing learning courses to accredit investors through an educational pathway

There are a range of existing learning courses available to prospective investors, which could be recognised under a more objective test. These programs have been set up to give angel investors theoretical as well as practical experience to understand the risks of the asset class and give them the knowledge necessary to invest. These include:

- [Startmate First Believers](#) - run by the most active early-stage startup investor in Australia
- [Airtree Explorers](#) - run by the second largest VC Fund in Australia
- [UNSW Angels](#) - run by UNSW, which has launched more successful startup founders than any other in Australia

These courses are designed to provide potential investors with the necessary knowledge to assess the risk of potential investments, and completion of these courses should allow for accreditation of investors as wholesale investors through an educational pathway.

Should Government want assurance about these courses and their independence, we consider that courses by recognised independent institutions could be automatically recognised (e.g. tertiary institutions). For other courses, an existing mechanism (such as DISR's Innovation Investment Committee or an industry body) could play a role in assessing against certain criteria to see if a course meets the criteria to provide an educational pathway for investors to become wholesale investors.

Mechanism 2 – Recognising the professional training or experience of an investor

Where an investor has proven professional training or experience in using financial services and investing in financial products that allows the clients to assess the merits, value, risks and information about the product or service, this should be considered sufficient to be recognised as a wholesale investor.

This is consistent with the approach taken by the UK, which provides a pathway for someone to be considered a wholesale investor where they:

- Are a member of a network or syndicate of business angels for at least six months
- Have worked in private equity or in the provision of finance for SMEs in the last two years, or
- Been the director of a company with an annual turnover of at least £1.6 million.

Recommendation 2: make changes to the existing experienced (sophisticated) investor test to allow for an objective determination of a potential investor's suitability.

The existing experienced investor test for assessing whether someone is an experienced investor could be improved by the introduction of objective criteria that would give AFS License holders clearer guidance by which to assess whether someone is an experienced investor, and therefore has the knowledge or capability to invest. The test should be improved by the following criteria:

- Providing clear examples of what counts towards previous experience and knowledge, so that the test is objective for AFSL holders rather than requiring a view on the prospective investors thinking, mindset and needs.
- Given the concerns raised by AFSL license holders about the consequences of an investor disputing an assessment of themselves as an experienced investor, provisions should be included for what happens when a challenge to the test is made by an investor. For example, making a provision that regulatory authorities will look at an investor's declared previous experience or professional training and the written acknowledgements.

Previous experience could include investors that that have:

- Previously completed investing activities that would be considered complex such as gearing, leverage, or derivatives
- Previously participated in investment decision processes using an Investment Manager at a fund
- Previously completed investments in an asset that is substantially similar to the product the client is wishing to be considered a wholesale client for.

Recommendation 3: if any changes are made to the asset or income thresholds for the wholesale investor test, they must be targeted and grandfathered

While we caution against a blunt increase to the existing income or asset thresholds, if the Government is inclined to make changed, they should consider more targeted reform options focused on the asset threshold, noting increasing property prices have largely been the reason for the broader growth in investor eligibility. A simpler change, with fewer unintended consequences to startups in Australia, could involve simply removing the family home from the assets test, which is consistent with other jurisdictions such as the US and UK.

Any potential changes to the asset or income test must also be grandfathered. If changes are applied to existing investments, this would create an immense amount of cost and complexity for investment funds, individual investors and startups and would be extremely detrimental to the tech investment landscape in Australia, particularly if investors that do not meet the revised thresholds are required to divest assets.

Importantly, the tech sector would not support increases to thresholds that are not accompanied by broader reforms to introduce additional alternative pathways, as outlined in recommendations 1 and 2.