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13 May 2024

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

By email: corporations.joint@aph.gov.au

Dear Secretary,

RE: Submission to the Parliamentary Joint Committee on Corporations and Financial Services inquiry into Wholesale investor and wholesale client tests.

Introduction

Halo Funds Management is the Investment Manager of the Succession Capped Interest Fund ("the Fund"). The Fund was established in 2019 with the objective of offering innovative ways to finance the ownership of retail pharmacies.

Most pharmacists work as salaried employees of the pharmacy, while ownership of the stores is concentrated in the hands of a relatively small cohort of individuals with a longstanding involvement in the industry. There is therefore a need to facilitate generational change in the ownership structure.

Only a qualified pharmacist can own a pharmacy in Australia. So the Fund was established with a loan product targeted at the needs of young pharmacists looking to attain ownership and an investment product designed to offer divesting owners an opportunity to continue investing in an industry which they understand while diversifying their risk.

We are therefore especially concerned that changes to the wholesale investors tests might severely limit the number of pharmacists who are able to invest in the Fund, thereby depriving aspiring owners of the opportunity to acquire and reducing the pool of capital which is available to established owners looking to divest.

Product Value Test

We do not believe the threshold for the product value test needs to increase. AUD$500K is a significant portion of the consideration a divesting pharmacist might achieve for his or her business and is typically outside the financial remit for most investors that are not institutional. Even if a pharmacist were able to afford the higher investment, in our judgment it would pose an unacceptable constraint on their ability to diversify as they contemplate security of income in retirement and other lifestyle choices.

Gross Income Test

We are of the opinion that adjustments to the gross income threshold for the individual wealth test are unnecessary. The current threshold of AUD$250,000 over the past two years remains sufficiently high in today's economic landscape, effectively limiting the classification of wholesale investors to a minority of Australians.

However, it is crucial to address the discriminatory nature of the current gross income test. The majority of pharmacists are women and options for parental leave are crucial in realising their ownership and investment aspirations. While it's important to note that not all individuals taking parental leave are women, they constitute a significant majority, thus facing disproportionate exclusion under the existing test. This issue persists unless the test incorporates additional components.

Exceeding the income threshold in a single year is paramount for maintaining eligibility for a period of two years, and any elevation of the threshold exacerbates this exclusionary effect.

To better account for investments made jointly and individually within family units, consideration should be given to implementing a household gross income test. Such a test would factor in the combined incomes of all parties within the household. I propose setting this threshold at 140% of the current individual threshold, equating to AUD$350,000. Notably, the United States has already adopted a similar provision.

This adjustment would promote fairness and inclusivity within the wealth classification system, ensuring that family circumstances are adequately considered while maintaining the integrity of the investor classification process.

Recommendations:

- Retain the gross income test threshold of AUD$250,000.
- Introduce a gross income test for a couple at AUD350,000.
- Consider adding a provision for individuals disadvantaged by an extended period of leave.

Net assets test and exclusion of assets

We propose maintaining the current threshold for the net asset test at AUD$2.5 million.

For many Australians, their primary residence constitutes a significant portion of their wealth. Excluding it from the net asset test would distort their true financial standing. It would also disadvantage individuals who have invested in property instead of other asset classes. Excluding the primary residence could potentially force investors that qualified solely based on this criterion out of their investments and damage their investment strategy.

However, if the primary residence were to be excluded from the assets considered in the test, the threshold would need to be proportionately adjusted to reflect this change. A threshold of AUD$1.0 million would be appropriate in such a scenario. This value would still indicate a certain level of financial sophistication, demonstrating an ability to grow wealth, evaluate opportunities, understand risks, and withstand potential investment losses.

Recommendations regarding the net assets test:

- Retain the threshold of AUD$2.5M for the net assets test with the primary residence retained in the assets being assessed.

- Reduce the threshold to AUD$1.0M for the net assets test if the primary residence is removed from the assets being assessed.

Ongoing Reviews

We believe there is merit in establishing a mechanism for periodic ongoing reviews into the future, but these would need to be considered reviews, not just adjusting values.

The 'simple' approach of implementing periodic adjustments based on a program of indexing the threshold values for the gross income or net assets tests, would achieve the aim of raising the thresholds, however it is likely to be ineffective and introduce further challenges.

Periodic reviews of the thresholds could be conducted at 5-year intervals and adjusted when deemed necessary to ensure they remain relevant for investors, the state of the economy, government policy and financial intentions.

Recommendations regarding reviews:

- Implement a program of proper reviews at 5-year intervals.
- Do not implement a program of indexing thresholds.

Grandfathering

If any changes are to be implemented, it is absolutely necessary to ensure a robust grandfathering program is put in place. Any changes to the wholesale client tests will need an appropriate transition period. If there is an increase in thresholds or exclusion of assets and an individual no longer qualifies as a wholesale investor both they and their investments will need a level of protection to avoid destructive financial distortion.

If periodic reviews are instituted, an element of the review must be determination of the grandfathering program to allow for any changes and minimise the impact of transitions.

Recommendations:

- Investors who met the wholesale client criteria, at the time of their investment, should maintain their status without retroactive changes affecting their prior investments.
- New wholesale client tests should be applied at the point of sale for new investments to prevent unintended or unfavourable investment outcomes resulting solely from changes in thresholds.
- Those already classified as wholesale clients should retain this designation in any existing funds they've invested in, allowing them to reinvest distributions and make additional investments without undergoing reassessment under updated financial thresholds.
- Individuals should remain categorized as wholesale clients for all financial services associated with a product, including interests in Managed Investment Schemes (MIS), acquired when they initially qualified as wholesale clients.

Kind regards,

[redacted]

Lisa Golden
Managing Director