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**By email to: [futureofadvice@treasury.gov.au](mailto:futureofadvice@treasury.gov.au)**

The Secretariat  
Future of Financial Advice  
Department of Treasury  
CANBERRA, A.C.T. 2600

Dear Sirs,

## **Wholesale and Retail Clients – Future of Financial Advice** **Response to Options Paper January 2011**

We refer to the Options Paper released in January 2011 and would like to table a response to two of the specific questions posed:-

Section 7.4 Is an arbitrary but objective test preferable to a subjective test which more accurately reflects the individual circumstances of the client?

Section 7.10 Should investors with less wealth but high financial literacy have some way of accessing wholesale products? If yes – how might this be operationalised in an objective manner?

### **Personal Background**

By way of providing some background details concerning the author of this Paper, I would point out my educational attainments include completion of an Economic Degree (1970's), completion of a Certificate in Business Studies (1980's) and completion of a Certificate in Investment and Financial Planning (1990's). These studies have been supplemented by a working lifetime of regular enrolment in Professional Development activities.

The author initially worked in commercial and private banking for almost 14 years and subsequently conducted a business consultancy practice for almost 17 years. The author has been an active investor in Australian equities for nearly 40 years.

## Responses to Specific Questions Posed

We would like to submit a response to two of the questions posed in the January 2011 Options Paper:-

### ***Section 7.4 Is an arbitrary but objective test preferable to a subjective test which more accurately reflects the individual circumstances of the client?***

We believe the wording of the question virtually answers the question itself.

Test criteria “which more accurately reflects the individual circumstances of the client” should, self evidently we believe, be set as the primary objective to achieve when seeking to frame such a test.

We believe that those seeking to be acknowledged, or even registered, as “sophisticated investors” should have their request assessed in a manner which accurately reflects their individual circumstances. We believe that an absolutely essential element in such an assessment is that proposed “sophisticated investors” are required to demonstrate knowledge in the specific financial product/s or service/s for which they wish to obtain “sophisticated investor” status.

The authors experience would suggest that high income and/or great wealth are no guarantee of financial sophistication. An elite sportsman may earn an enormous income but have only a rudimentary knowledge of financial products and services. A successful factory owner may have amassed great wealth from a lifetime of operating a business but may be a novice when it comes to financial service and products.

Despite their high incomes and/or great wealth, these individuals still need, and should be entitled to, the protection currently afforded to investors of much less significant means. If a test for financial sophistication is based simply on objective measures of income and/or wealth, these individuals may not readily obtain the protection they need.

Alternatively, if a test for financial sophistication is based on more subjective measures, and demonstrable experience in understanding and dealing with the specific product is the predominant criteria, the opportunity to be classified as “sophisticated investors” may well be provided to a wider group of individuals. The subjective nature of the “test” will ensure that those so classified are truly “sophisticated investors”.

As an aside, even today where specific, objective, numerical criteria are available for defining a “sophisticated investor”, some confusion still reigns. Where an individual investor controls multiple investing/trading entities, it is widely considered that each entity must meet the income or wealth criteria in its own right to be classified as a “sophisticated investor”. Further, it’s widely held that amalgamating the income earned and/or wealth held by the single investor from all his investing/trading entities cannot be used as a basis to qualify all of this trading/investing entities as “sophisticated investors” (even where such entities have one or more “associated entities” already classified as “sophisticated”).

***Section 7.10 Should investors with less wealth but high financial literacy have some way of accessing wholesale products? If yes – how might this be operationalised in an objective manner?***

In normal commerce, “wholesale” terms and prices are offered to clients who can take product in far larger quantities than normal retail clientele. The basis of the discounts offered is that the seller can generate overhead, transport and distribution cost savings by selling a larger consignment of goods to a single buyer. The “wholesale price” discount reflects the passing on of some part of the wholesalers cost saving.

In the current financial services environment, overhead and transport costs are negligible. A significant cost, however, when dealing with retail clients, is the distribution cost and a large component is the cost involved in providing Product Disclosure Statements, Prospectus’ etc. required by law.

However, when dealing with those currently classified as “sophisticated investors”, the product or service provider can dispense with a number of these requirements because the law accepts that the “sophisticated investors” possess a high degree of financial literacy and are able to make their own, independent judgements about the relative merits of the product or service offered.

As suggested previously, high levels of income and/or substantial financial wealth don’t necessarily imply financial sophistication. Conversely, many investors of lesser income or wealth possess high financial literacy,

We believe the possession of financial literacy, and the capacity to understand the product being offered to them, should be sufficient to allow access to “wholesale” offerings by investors of lesser wealth.

We believe the classification of such individuals as “sophisticated investors”, based on an assessment that they possess high financial literacy rather than just being based their income or financial means, could achieve this aim. The according of “sophisticated investor” status could be limited to a particular product or service, or a range of products and services, depending on the experience and assessed knowledge of the individual concerned.

Financial service providers are expected to “know their client” when providing financial products and services. Whilst in practice they may lack detailed knowledge of their retail and mass market clientele, they have much greater and more detailed knowledge of the more active and longstanding members of their clientele who would be seeking out “sophisticated investor” status.

In fact, these types of clients are more likely to already be receiving a higher level of service and advice from the product and service providers; a level of service and advice which would “accurately reflect their individual circumstances”.

In seeking to provide a subjective assessment of who would be appropriately classified as a “sophisticated investor”, it is clear that much of the burden in “accurately reflecting the individual circumstances of the client” could fall upon the provider of the relevant financial product or service.

In reality, as discussed, these providers already have detailed knowledge about those of their clients most likely to be seeking “sophisticated investors” status, and the task for these providers in making appropriate assessments shouldn’t be onerous nor involve any financial impost.

At present, many smaller, though financially savvy, investors may be precluded from availing themselves of “wholesale” type products and opportunities. For the providers of such products and opportunities, the capacity to classify these investors as “sophisticated investors” may provide scope to broaden their client base, and any costs involved in the assessment process may be more than recouped by the additional business generated.

The providers would, however, have a duty of care not to simply allow any investor seeking “sophisticated investor” status to be approved as such. They would need to be able to demonstrate that they had not acted negligently in according a client “sophisticated investor” status which, whilst allowing the client easier access to certain product offerings and opportunities, would diminish the clients right of redress if the result of the investment decision didn’t achieve what it was expected to achieve.

### Conclusion

Whilst acknowledging that many, many retail investors benefit enormously from protections currently provided by legislation, we believe the relevant Acts are based on a mass-market, “lowest common denominator” factor, and that individuals with higher levels of financial literacy face unnecessary restrictions as a result of attempts to protect the majority.

We believe that legislation should provide an opportunity for those with higher levels of financial literacy, who are prepared to take full responsibility for their own investment decisions, to avail themselves of wholesale products and services currently only available to those classified as “sophisticated investors”.

The simplest means to achieve this would seem to be by allowing those with demonstrable skill and knowledge about particular products or services to be able to be classified as “sophisticated investors” themselves without reference to their income levels or the quantum of their private wealth.

We would urge those undertaking the Wholesale and Retail Clients - Future of Financial Advice review to provide experienced and capable smaller investors with the flexibility to access appropriate “wholesale” product offerings as a right they’ve earned by demonstrating their advanced level of financial literacy, knowledge and skill.

Regards,

Geoff Cossar  
Director