PITCHER PARTNERS
ACCOUNTANTS AUDITORS & ADVISORS

Level 19
15 William Street
Melbourne
Victoria 3000

Tel: 03 8610 5000
Fax: 03 8610 5999

Postal Address:
GPO Box 5193
Melbourne Vic 3001
Australia

www.pitcher.com.au
partners@pitcher.com.au

Pitcher Partners, including Johnston Rorke,
is an association of independent firms
Melbourne | Sydney | Perth | Adelaide | Brisbane

23 February 2011

Attention: Dr Richard Sandlant
Future of Financial Advice
Department of Treasury
Langton Crescent
CANBERRA ACT 2600
By Email: futureofadvice@treasury.gov.au

Dear Dr Sandlant

OPTION PAPER JANUARY 2011 - FUTURE OF FINANCIAL ADVICE WHOLESALE AND RETAIL CLIENTS

Objective Test Measures Wealth Not Sophistication

We agree that the current wealth tests under sections 708(8)(c) and s761G(7)(c) of the *Corporations Act 2001* may have become too easy to satisfy, potentially enabling relatively unsophisticated investors to gain access to wholesale products without adequate disclosure or understanding of the risks associated with these products.

It is not uncommon for an unsophisticated investor to easily meet current objective tests, regardless of whether the family home is or is not included. This may occur, for instance, when a more sophisticated controlling spouse dies or becomes incapable of making decisions and future decisions are required to be made by a more passive and/or unsophisticated spouse.

Income and asset thresholds are a reasonable starting point when looking to define a sophisticated investor and we recommend that this objective test remain. The income threshold of $250,000 per year over two years remains reasonable in most circumstances although this should be indexed to avoid becoming outdated. The $2.5 million net asset test is also reasonable, although this test should not include the family home and should also be indexed to remain relevant.

Subjective Tests Create Uncertainty and Confusion

It is also our view that applying a subjective test is confusing and difficult to administer. Two professional advisors or accountants may form a different opinion about the level of sophistication for the same person. This could result in a client shopping around until they find someone who is prepared to classify them as sophisticated. A subjective test may lead to conflicts of interest as professionals seek to satisfy clients.

Clarification required around Self-Managed Superannuation Funds

The difficulty with this subject is that it is very hard to reach certainty on who can be a wholesale investor. There is contention over the definition of a 'person' and whether a self-managed superannuation fund (SMSF) can be a 'person' for the purposes of satisfying s708(8).

Ordinarily, a self-managed superannuation fund (SMSF) is treated as a trust and could be a wholesale investor if the assets of a person who controls that trust/SMSF meet the threshold net asset or income test. This view is held by many product providers, accountants, financial planners and lawyers.

However, under ASIC's current interpretation of the relevant provisions, a certificate given to the controlling person cannot apply to a SMSF and a SMSF is treated as a retail client in respect of financial product advice unless it meets the professional investor definition of owning assets of $10 million or more.

Unfortunately the position at law has not been tested as yet. Our view is that an SMSF that meets the income and assets test should be able to be classified as a sophisticated/wholesale investor.

Sophisticated Investor Self Selection

The primary benefit of being a sophisticated/wholesale clients is that it allows access to wholesale investments. A sophisticated/wholesale client essentially forgoes disclosure and the protection of receiving a Product Disclosure Statement (PDS) and other ongoing disclosure documents, but potentially gains access to unique, limited, more complex and often lower cost investment opportunities. For a wholesale offer the PDS is generally replaced by an Information Memorandum (or similar document) and limited ongoing reporting/disclosure.

The view taken by the regulator is that higher upfront and ongoing disclosure obligations for retail clients provides them with greater levels of disclosure and therefore protection. In practice however this argument may not be strong. Retail clients may be less likely to read a complex and extensive PDS than they might a simplified one page Information Memorandum.

It is our view that investors should be obligated to self select as sophisticated investors. In other words, an investor should be required to acknowledge that they qualify as a sophisticated investor under the net asset and/or income tests and that they are prepared to forgo the minimum upfront and ongoing disclosures that would normally apply to a retail investor.

If you wish to follow up in relation to this submission please contact Geoff Gray, Director of Business and Compliance, on (03) 8610 5363 or via email at geoff.gray@pitcher.com.au.

Yours sincerely

SUE DAHN
Partner