

March 2011

# Wholesale and retail clients Future of Financial Advice

**TO:**

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SELF-MANAGED SUPER FUND  
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Self-Managed Super Fund Professionals'  
Association of Australia Limited  
(‘SPAA’)

## Overview

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This submission addresses the questions for consideration in the Options Paper released by the Government on the application of the wholesale client and sophisticated investor tests in the Corporations Act 2001 (the Act).

SPAA’s response to the questions for consideration underlines SPAA’s support for option 1 as outlined in the Options Paper but with the following modifications:

- i. To ensure the three wealth and product value threshold tests continue to remain relevant over time, the existing three wealth and product value thresholds tests should be indexed every five years.
- ii. Retail client status should apply to all persons acquiring investments in superannuation funds, or services relating to those investments. However, this retail client status should not apply in situations where financial products and services that do not specifically relate to a member’s interest in the fund are provided to the trustees of a superannuation fund.
- iii. Self Managed Superannuation Funds (SMSF) who have trustee/members who meet the wholesale client tests in the Act should be considered wholesale clients under the Act. The thresholds for wealth in net assets or gross income for SMSF members should be determined jointly if both members of an SMSF are members of a couple.
- iv. The “sophisticated investor test” should be repealed. The subjective nature of the sophisticated investor test makes this test difficult to administer and can give rise to conflicts in relation to the judgement of those who apply the test.
- v. A person who qualifies as a wholesale investor should be required to elect to be treated as a wholesale investor.
- vi. The family home and superannuation balances in APRA regulated funds should be excluded from the net asset threshold test. However, in recognition of the high level of member engagement and involvement in the fund’s investment decisions, a person’s SMSF balance should be included in the net asset threshold test.

As a general comment, SPAA believes any reform to the retail/wholesale distinction should revisit the separate provisions in relation to chapters 6D and 7 including the differences between them, and adopt the one set of definitions for the retail/wholesale distinction that apply consistently across the entire Act.

## About SPAA

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The Self Managed Super Funds Professionals’ Association of Australia (“SPAA”) is the peak professional body representing the self managed superannuation fund (SMSF) sector throughout Australia. SPAA was established in April 2003 to advance the professionalism and collaboration of professionals working in the highly complex area of self-managed superannuation and to develop and maintain high

standards of advice for trustees and members of SMSFs. In September 2010, SPAA was admitted by the Tax Practitioners Board as a Recognised Tax Agent Association.

SPAA is committed to raising industry standards and looking after the needs of SMSF professionals across Australia regardless of their other professional affiliations or membership. SPAA's core focus is to raise the standard of advice provided by all professionals within the SMSF sector. SPAA has developed an accreditation standard to ensure professionals standards are achieved and maintained by practitioners specialising in the provision of services to the SMSF sector. This is the first standard in Australia to offer independent verification and certification of a practitioner's competency, independence, experience and knowledge.

The Association is committed to promoting high standards of education among SMSF professionals and assisting them to work within the regulatory framework. This, in turn, will assist the industry to self-regulate and promote best practice.

## Questions for consideration

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### Option 1 – Retain and Update the Current System

#### 7.4 Update the Product Thresholds

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

**SPAA's response:** *An objective test is desirable which may result in an equitable outcome. This may include some and exclude others, however, it has the advantage of relative simplicity and being easy to measure. A subjective test may provide a number of conflicts in relation to the judgement of those who are determining whether a person meets or does not meet the relevant test. If a subjective test is desired, any assessment needs to be undertaken independently of the parties associated with the relevant investment decision. Any judgement that is required must be independent of the adviser, licensee and the product provider.*

- Should all 3 thresholds be updated (that is, the product value test and the two tests based on personal wealth in s761G(7)(c), or just the \$500,000 product value threshold?

**SPAA's response:** *The three tests should be updated due to the changes in personal wealth and earnings. However, it is considered that the components to be included in the measurement of personal assets should only include elements which relate to investable assets. This would exclude the family home and superannuation where the fund member has no direct control over investment decisions relating to their benefit.*

- Is \$1,000,000 an appropriate new threshold limit for the product value test?

**SPAA's response:** *In view of international models and the rules in the USA an amount of \$1m would appear appropriate in the circumstances.*

- Is information available on how many investors would meet the proposed new limit for their products?

**SPAA's response:** *SPAA does not know of any information available on the number of investors who would meet the new limits for products.*

- Is there any specific reason why regulation 7.1.22 should not be amended to more accurately reflect the investment a client actually makes in a derivative?

SPAA has no comment on regulation 7.1.22.

## 7.5 Introduce an Indexing Mechanism

- How could a simple and relevant indexing mechanism be introduced?
  - An example of a simple mechanism may be to assume a certain percentage growth per annum and legislate that the thresholds must be updated to a round number based on that growth rate with effect every 5 years

*SPAA's response: The use of indexation will have the effect of retaining value of the three tests. A five year review of these thresholds would appear appropriate.*

- Will three different threshold limits and constant indexing be too difficult or confusing to implement?

*SPAA's response: If the indexation occurs too frequently then confusion will result. However, if indexation occurred on a five year basis changes would reflect reasonable changes to the value of money. This would achieve a reasonable balance.*

- What value should be used as the basis for indexing?

*SPAA's response Indexation of personal income could be based on changes to a salary index such as AWOTE and indexation of personal wealth could be based on CPI.*

- How often should the 3 limits be indexed?

*SPAA's response Indexation on a five year basis would appear appropriate. Indexation at more frequent intervals may result in confusion and uncertainty. Indexation at less frequent intervals may result in the thresholds not representing a reasonable change in the value of money.*

## 7.6 Exclude Illiquid Assets

- Are there any reasons why a primary residence should/should not be included in the net asset test?

*SPAA's response It is considered that the primary residence should not be included as the measurement should include investable assets only.*

- Are there any specific reasons why superannuation should/should not be included in the net asset test?

*SPAA's response In relation to superannuation being included in the measurement of net assets SPAA considers that superannuation balances in APRA regulated funds should be excluded from the test as members do not have control over when and how the investment of the fund investments take place. This would not be considered as an investable asset of the individual. However, in the case of members of an SMSF as the members of the fund are generally the fund trustees the investment decision is similar to that of a personal investment decision. Therefore the member's balance in the SMSF should be included in the person's net assets.*

- Would excluding some assets cause too much difficulty or confusion for the industry?

**SPAA's response** *If the assets excluded were strictly limited to some categories, such as the family home or superannuation balances in APRA regulated funds any difficulty or confusion will be kept to a minimum.*

- Would this work prohibitively to exclude clients who should be classified as wholesale?

**SPAA's response** *This would not work prohibitively to exclude some clients who would be considered as wholesale clients. Whatever system of objective measurement is used there will always be some who will be included or excluded and may or may not qualify under the rules.*

## 7.7 Amend the Deeming Process

- Would an explicit opt-in make investors sufficiently aware of what protections they are afforded?

**SPAA's response** *An opt-in election by the client would be appropriate to ensure they are not unknowingly included within the definition of a wholesale investor. The client would need to meet the relevant criteria before the election could be made. Any criteria should be assessed objectively.*

- Would an explicit opt-in be prohibitively inefficient for industry?
  - What would be a more appropriate test for investor opt-in?

**SPAA's response** *The consideration here is not the inefficiency for the industry but rather whether the person who is to make the investment is suitable for the investment and understands the consequence of the decision they make*

- Would the true policy objective and message be easy to avoid via standard forms?

**SPAA's response** *It may still be possible to achieve the objectives via the use of a standard form providing the assessment of the client is made independently.*

- Should investors be able to elect to be treated as a retail client even when they meet the wholesale wealth threshold tests?

**SPAA's response** *Investors should be treated as retail clients unless they are able to meet the requirements of the objective tests. Where this is the case they should be given the opportunity to elect to be treated as a wholesale investor.*

## 7.8 Two out of Three Requirements

- Are there any specific reasons why meeting 1 out of 3 requirements is better than meeting 2 out of the 3 (or vice versa)?

**SPAA's response** *Satisfying only one of out three requirements instead of two out of three requirements may result in more individuals, who arguably do not have the necessary experience investing in complex financial products, being able to accessing wholesale investment markets. For example, if a client is only required to meet an income test, they may be able to meet the wholesale investor test by simply receiving a windfall gain or earning a high income for relatively short periods.*

- Is meeting 2 out of the 3 requirements likely to be a better proxy for financial literacy than the current test?

**SPAA's response** Please refer to the previous answer

- Would this requirement be prohibitive for investors who wish to be classed as wholesale?

**SPAA's response** Any objective criteria will result in some who are included and excluded from the definition. Those who wish to be included as wholesale investors need to meet the criteria which is independently assessed before they can be included as wholesale investors.

## 7.9 Introduce Extra Requirements for Certain Complex Products

- What are the complex products that the higher threshold should apply to?

**SPAA's response** There will be a number of definitional issues that will arise in determining what is a complex product. What may be complex for one investor may not be for another. If it is considered a higher threshold should apply, in effect, another category of investor is being created, the wholesale investor with knowledge in complex products. If it is desired that the categories be kept as simple as possible then only two categories, retail and wholesale client, should exist.

- What is the higher threshold that should apply to these products?

**SPAA's response** SPAA does not propose that the complex product investor category should be developed and therefore there would be no requirement for a higher threshold to be adopted.

## 7.10 Repeal the 'Sophisticated Investor' Test

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

**SPAA's response** There are a number of issues with the use of objective criteria especially where the qualification is based on an assessment by those associated with the purchase or sale of the product. An objective criteria should be assessed independently of parties who have a direct or indirect interest in the investment. It may be possible for retail investors who do not qualify as wholesale investors under the subjective criteria to obtain a qualification based on competency which will allow them to invest as wholesale investors.

- Given that the industry favours objective tests over subjective tests, is this a strong enough reason to repeal the section entirely?

**SPAA's response** If there are two categories of investors decided upon, retail and wholesale, and the ability to be treated as a wholesale investor is based on an objective test then it would appear appropriate that the sophisticated investor test is repealed.

- Should the section be retained even if it is scarcely used?

**SPAA's response** If two client categories are adopted it is appropriate that the section should be repealed.

## Option 2 – Remove the Distinction Between Wholesale and Retail Clients

- Would the financial advice industry be willing to undertake a suitability test and best interests verification for each retail client that personal advice is provided to under the retail client definition proposed in this option?

**SPAA's response** *While the best interests verification has merit it may result in compromise where the adviser or provider of the product has taken an aggressive stance to the sale. It is considered that the proposal in this paper to use objective criteria backed up by the client making an election to be treated as a wholesale client is a more efficient criteria.*

- Is the loss of efficiency offset by greater investor protection?

**SPAA's response** *If objective criteria is used it is considered an efficient model.*

- Is it appropriate to remove the distinction from the entire Act?

**SPAA's response** *Removal of the distinction to treat all parties as retail clients creates issues in relation to certain parties who meet the criteria to be treated as wholesale investors. Removing the distinction would lead to a loss of efficiency and increased costs due to the need for the consumer protection and disclosure regime to be extended to investors who arguably do not need this protection or level of product disclosure. As a general comment, any reform should revisit the separate provisions in relation to chapters 6D and 7 including the differences between them, and adopt the one set of definitions for the retail/wholesale distinction that apply consistently across the entire Act.*

### **Option 3 – Introduce a ‘Sophisticated Investor’ test as the sole way to distinguish between wholesale and retail clients**

- Is the test under section 761GA a true indication of financial literacy?

**SPAA's response** *It is considered that a test of financial literacy that is independently assessed is the best measure. However, the complexity and perceived uncertainty in whether a person actually meets that level of competency casts into doubt whether there is a cost effective and simple way of achieving the objective.*

- Is there any way that section 761GA can be amended to allay fears of licensees being exposed to legal liability while maintaining investor protection?

**SPAA's response** *It is considered that licensees are not appropriate to undertake the assessment process as it should be independently assessed to avoid any conflicts that may arise.*

- Is it possible for a subjective test to be easy to administer and ensure that intermediaries are not unduly cautious?

**SPAA's response** *SPAA makes no comment in relation to the development of a subjective test as it considers an objective test is the favoured approach.*

### **Option 4 – Do Nothing**

- Is there any reason why the current tests should be retained in the face of problems experienced during the GFC?



**SPAA's response** *It is considered that a modification of the current objective tests, as proposed in this submission, should be retained. The use of other tests or the development of a subjective test introduces unnecessary complexity and cost and provides little benefit to clients and providers of financial products and advice.*

- Are the monetary threshold limits still relevant?

**SPAA's response** *As a reasonable rule of thumb it is considered that monetary thresholds should be retained.*

- Should they be increased? If so, by how much?

**SPAA's response** *It is considered that the thresholds should be increased to more relevant amounts as suggested earlier in this submission and subject to indexation every five years.*

### **Further Considerations**

- Is the professional investor still valid?

**SPAA's response** *The definition of wholesale investor would include the professional investor definition.*

- Do any classes of investor need to be added or removed from the list of professional investors?

**SPAA's response** *If the investor classes are divided into retail and wholesale, which distinguishes between those who need protection and those who don't, there is no need for a specific class of investor referred to as a professional investor.*

- Should professional investors continue to be subject to the same protections and disclosures that they currently receive?

**SPAA's response** *On the basis of this submission if they elect to be treated as wholesale investors then any protection they would be afforded would be limited.*

- Is further clarification needed regarding the interpretation of s761G as to the confusion regarding 'in relation to a superannuation product' in s761G as it applies to financial services and product made available to the trustee of a superannuation fund (other than superannuation products).

**SPAA's response:** *We do not agree with ASIC's interpretation that where a financial service is provided to a trustee of a superannuation fund it is always provided "in relation to" a superannuation product. Such a broad interpretation of section 761G means a superannuation fund could never satisfy the definition of a wholesale investor unless the fund has net assets of at least \$10 million. The results which flow are nonsensical and could not have been the intention of policy makers. For example, while an investor may be able to invest in financial products or be provided financial services as a wholesale client, their SMSF would not be able to invest in these products or be provided services as a wholesale client unless their SMSF has net assets of at least \$10 million.*

*A better view is that the issue of a financial product (which is not a superannuation product) to the trustee of a superannuation fund does not "relate to" an interest in the fund itself and therefore it is not caught by subsection 761G(6)(b). The financial product in this scenario would be provided to*

*the trustees of the superannuation fund on a wholesale client basis if the trustee of the fund satisfies one of the wholesale investor tests in subsection 761G(7).*

## **Further Information**

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We would be pleased to provide you with any further information in support of our submission.

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