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**Review of the regulatory framework for managed investment schemes –  
response to consultation paper**

We welcome the opportunity to respond to the issues paper published in August 2023.

Kit Legal is a specialist financial services law firm. We act for over 100 financial services firms around Australia, assisting them to comply with their regulatory obligations. Most of our clients are SMEs that hold their own AFSL.

We have only responded to the questions related to the wholesale client tests, because this is the issue of most importance to our client base.

In our direct experience, the current wholesale client tests are not being applied improperly to avoid obligations under the Corporations Act. In classifying a client as a wholesale client, the advisers we work with are responding to their client's needs rather than pushing a wholesale client status onto the client.

Many clients want to have a more flexible and dynamic advice relationship with their adviser. Retail disclosure documents such as Statements of Advice are often not relevant or desired by these clients, nor can they access alternative investments more suited to their financial goals in the retail environment. Our wholesale fund manager clients are providing a key component to their investors' diversified portfolios where the investment is specifically sought by the investor. They are not spruiking products or pressuring any investor to be classified as a wholesale client.

We see the approach of both our financial advisory and fund manager clients as acting within ethical parameters and in line with the overall spirit of the legislation, which intends to offer protections to those who need it and greater access and flexibility to those who don't.

We appreciate that our experience of this issue does not represent the entirety of the wholesale funds sector. We don't believe that legislative changes should be made just on anecdotal reports of what is occurring. Given the extent of significant upheaval that would occur across the wholesale funds industry if the wholesale client tests were changed, we think the first step should be to gather specific data on how many consumers have suffered loss due to being classified as wholesale clients and whether this loss would have been prevented if they had been treated as retail clients. We believe data is required to clearly understand 'the problem'

before we work on 'the solution' given the very significant ramifications that will arise from changing the tests.

We welcome any queries on our submission and otherwise look forward to reading the final report.

Kind regards

A handwritten signature in blue ink, appearing to read 'C Evans', is positioned below the text 'Kind regards'.

The team at Kit Legal  
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## **Response to the review of the regulatory framework for managed investment schemes (MIS)**

### **Wholesale client thresholds**

1. Should the financial threshold for the product value test be increased? If so, increased to what value and why?

No.

This is an objective threshold, which is easily applied and works well in practice.

2. Should the financial thresholds for the net assets and/or gross income in the individual wealth test be increased? If so, increased to what value and why?

No, we don't think the thresholds should be increased. However, we do advocate for changes that we believe would enable the test to be applied more simply and with more confidence.

If the primary residence is excluded from the asset calculation (see question 3), then our view is that the overall threshold should be reduced to take this into account.

Increasing the financial thresholds in the individual wealth test will have wide-ranging consequences that stretch well beyond the MIS framework. Any changes to the thresholds must be considered in this broader context. We would like to see data showing how many consumers who have been classified as wholesale clients have actually suffered loss as a result of that classification before proposing to change the test.

#### *Consumer protection rationale*

Financial services reforms have typically been aimed at protecting retail clients.

While we note the increasing percentage of individuals qualifying as wholesale clients quoted in the Consultation Paper, we are unaware of any evidence that consumer protection would be improved by increasing the financial thresholds.

We suggest that any decisions on changing the thresholds should be informed by data on loss suffered by the wholesale client sector and an analysis of how this could have been prevented. This data would enable both the legislature and the financial services industry to be clear on the problem we are trying to solve by legislative change.

It's also worth recognising that while retail clients enjoy greater protections conferred by Chapter 7 of the Corporations Act, statutory protections are also in place for wholesale clients, including:

- The significant protection afforded by the AFSL general obligations, including the obligation to ensure financial services are provided efficiently, honestly and fairly, have adequate arrangements for managing conflicts of interest, maintain adequate risk management systems, maintain competence etc.

- Protection afforded by other AFSL requirements, including financial requirements, client money obligations and breach reporting obligations.
- Conduct regulations (in the Corporations Act and ASIC Act)
  - False or misleading representations, and misleading and deceptive conduct provisions. These were enforced in the wholesale sector in ASIC's case against the Mayfair group of companies for misleading or deceptive advertising of financial products to wholesale clients, which saw a \$30 million penalty, amongst other orders, imposed on the companies.
  - Unconscionable conduct provisions.

Given these protections (and in the absence of evidence of significant loss or misconduct in the wholesale sector) we argue that any changes should focus on other elements built into the individual wealth test that effect how it operates, including the concept of 'control'.

#### *'Controlled'*

In our experience, one of the key issues in applying the individual wealth test is the difficulty accountants face in determining when a company or, in particular, a trust is 'controlled' by an individual so that the income/assets of the company or trust can be included in the wealth calculation (see ss761G(7A) and (7B) as inserted into the Corporations Act by reg 7.6.02AC). This is an area of real uncertainty.

Our view is that issues have arisen, in part, because the control provisions principally developed to deal with other parts of the Corporations Act (such as relevant interests in the takeovers context), confuse the concept of control and how it applies in the context of the wholesale client test.

In our view, the legislative intent is that the test should be agnostic as to how an individual or family chooses to hold its wealth, whether held directly or via companies or trusts (including SMSFs). How the control test applies in the context of trusts, and specifically SMSFs, should be clarified to uphold the legislative intent.

Currently there are a multiple legal opinions on how the provisions apply in the context of SMSFs. There are also different applications where there are individual versus corporate trustees, and different interpretations on when assets of a trust can be 'counted' in assessing whether the client meets the test.

This places the accountant signing the Accountant's Certificate in a very difficult position and creates legal uncertainty, cost and risk. In many families, assets will be jointly held and controlled either directly or via company or trust structures. The test must be clear on how it applies in this context so that accountants can have confidence in making their assessment.

We suggest that a specific definition of control should be developed for this test with clear examples to reflect the most common scenarios. This definition should expressly consider the concept of control in the context of the individual wealth test (including as it should apply to an SMSF).

3. Should certain assets be excluded when determining an individual's net assets for the purposes of the individual wealth test? If so, which assets and why?

As we have said above, we believe the test should stay as is until further data is obtained on the 'problem' we are trying to solve.

Notwithstanding this, if a decision is made to exclude certain assets, our view is that an individual's primary residence is the most appropriate asset to be excluded from the individual wealth test.

Excluding the primary residence is consistent with the approach taken to assessing various pensions and payments under Centrelink, as well as the banking sector's reticence to take guarantees over the family home.

We do not believe superannuation should be excluded. As stated above, we believe that the spirit of the legislation is that an individual or family can choose how they accumulate and hold assets. For instance, we don't believe that an investor should be prevented from being classified as a wholesale client because they have made a decision to contribute to their superannuation fund rather than hold investments in a family trust or company outside the superannuation environment.

4. If consent requirements were to be introduced:

(a) How could these be designed to ensure investors understand the consequences of being considered a wholesale client?

The consent should be short, simple, direct and acceptable by all platforms and providers.

It shouldn't be subject to interpretation by Licensees on what should or shouldn't be included.

(b) Should the same consent requirements be introduced for each wholesale client test (or revised in the case of the sophisticated investor test) in Chapter 7 of the Corporations Act? If not, why not?

Yes, the same consent requirements should apply for each wholesale client test.

Requiring different forms of consent would only complicate things without any benefit to the consumer.