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Review of the regulatory framework for managed investment schemes
Joint submissions in response to consultation

We refer to the Treasury Consultation paper in relation to the Review of the regulatory framework for managed investment schemes. In response to the request for feedback, we make this joint submission.

Introduction

Arnold Bloch Leibler

Arnold Bloch Leibler (***ABL***) is a premium Australian commercial law firm, renowned for advising clients on their most important transactions, commercial issues, and disputes. The firm provides advice to a diverse range of entrepreneurial Australian listed companies, private businesses, senior executives, international corporations, and private clients.

ABL guides new economy entrepreneurial clients throughout their journey from start up to raising capital, through to public listing, global expansion, and exit. We have extensive experience in working with investors and venture capital firms.

In addition, we have advised on some of Australia's largest and most complex corporate restructuring and insolvency matters, including acting for the insolvency administrators of the Timbercorp, Willmott, and Gunns managed investment schemes.

Euphemia

The Euphemia Group (***Euphemia***) is the family office of Dom Pym, an Australian entrepreneur and technologist who co-founded several businesses, including Up (Australia's leading digital bank) and Pin Payments. Dom is an Advisory Board member for the Bendigo and Adelaide Banking Group and serves on the Board of Directors for Fintech Australia. Judy Anderson-Firth is the Group CEO and leads Euphemia's ~$70million global investment portfolio, including private and public equities, venture capital and property portfolios. Prior to her role with Euphemia, Judy was the CEO of Startup Victoria (now known as The Startup Network), Australia's largest network for entrepreneurs, with over 60,000 people in the community.

Euphemia invests directly in startups across four focus areas – Fintech, Climate Tech, Women-led and Startup Infrastructure – typically pre-seed to Series A. As a family office, Euphemia also invests in venture capital and private equity funds and traditional assets classes. Euphemia supports founders from a range of diverse backgrounds who have not had equal access to opportunity.

Having been lead investor for the seed raise by Aussie Angels, in 2023, Euphemia launched an investment syndicate on the Aussie Angels platform to share dealflow with Euphemia's network of co-investors from other family offices, venture capital and angel investors, ecosystem partners and founders.

Submissions

In making this joint submission, we have focused on the proposals concerning wholesale client thresholds, as an area in which our respective experience provides a similar perspective, and which we consider may have significant consequences for investors and entities seeking capital.

Overview of joint submission

We submit that the desire to protect more people as retail investors needs to be weighed against the consequences of any change to the existing thresholds. We note, for example, that the majority of investors in the multitude of Timbercorp, Willmott Forests and Gunns managed investment schemes were retail investors. We are of the view that changes to the wholesale investor regime would not have offered them any further protection.

The ability to seek wholesale investors under a less restrictive regulatory regime provides startups, emerging venture capital funds, angel investor syndicates and entrepreneurial businesses a cost effective and timely means of raising capital. These types of entities require flexibility and speed to overcome the challenges they face. Any reduction in the pool of wholesale investors available will reduce the competitiveness of the entities. Many of them will not have the funds, resources, or time available to satisfy the more detailed regulatory requirements applicable to retail investments. Not only will those entities flounder, but Australian investors who understand the inherent risks of such investments will be denied the opportunity to invest in this class of assets.

With limited Australian venture capital funds able to make investments, startups, emerging venture capital funds, angel investor syndicates and entrepreneurial businesses will look to international funds, with less prescriptive membership rules, to provide them with necessary funding. This will reduce the competitiveness of Australian funds and reduce the accessibility to this asset class for Australian investors. Ultimately reducing the pool of technology companies that remain Australian domiciled, impacting job creation, GDP, and company income tax revenues for the Australian Government.

We acknowledge that the ability of a person to satisfy a monetary threshold does not necessarily reflect the ability of that person to understand the inherent risks of any investment they may make. We see scope for the introduction of an independent test based on experience, professional training, or education as an alternative basis for determining an investor’s status. However, as such a test or training program is not currently in existence, it will take time to develop and implement a suitable program, to identify and accredit appropriate providers, and for investors to satisfy the requirements of that program. This must therefore be viewed as, at best, a long-term solution.

In the interim, while tests based on monetary thresholds and the sophisticated investor test under section 761GA of the *Corporations Act* have their limits, they offer a reasonable basis for distinguishing between types of investors.

However, care must be taken with tests based on monetary thresholds to ensure that they do not discriminate against women, given the gender pay gap, or persons who have taken extended periods of parental, carers, or other leave.

We submit that the financial thresholds for the product test and gross income should not be increased at this time. We submit further that these thresholds should be subject to periodic review to determine their ongoing suitability. The gross income test should be amended to ensure that persons who have taken extended periods of leave are not excluded, by virtue of that leave, from satisfying the test for two years after their return to the workforce.

We recognise that the suitability of the net assets test has been impacted by the growth in the value of residential property. Rather than increase the net asset threshold, we submit that an investor’s primary residence should be excluded from the test. If the primary residence is to be excluded, we submit that the threshold for net assets should be reviewed to determine an appropriate lower level having regard to its exclusion. We submit further that this revised threshold should be subject to periodic review to determine its ongoing suitability.

If there are to be changes to the monetary thresholds, we submit that a transition period will be required to ensure that investors have an adequate opportunity to satisfy those thresholds and entities seeking wholesale investors are not unduly disadvantaged during this period. We believe a transition period of at least 36 months would be required to provide entities with adequate time to adjust their business model, go to market strategy and ensure they comply with any new regulatory requirements. In addition to any transition period, investors who satisfy the current thresholds, and investments in which they have invested and may make re-investments or follow on investments should be grandfathered, with changes to the thresholds not applying retrospectively.

Joint submission – Chapter 1: Wholesale client thresholds

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

No, the financial threshold for the product value test should not be increased. An investment of $500,000 or more in a single product or entity remains a very significant investment, which will generally only be made by an investor after due consideration of the investment and the risks involved. The amount of $500,000 represents more than 5 times the full time adult average total earnings[1]. Given this, the vast majority of Australians investing would not meet this test.

While it is likely that investors meeting this test could also meet either the net assets or gross income test, to do so they would be required to provide a certificate from a qualified accountant. This would add unnecessary compliance measures for the investors and the entity in which they are investing, thereby potentially affecting the speed at which investments could be made.

The threshold should be subject to periodic review to ensure it remains relevant. We are not in favour of annual CPI increases as this will add unnecessary complexity.

If a change to the threshold were to be introduced, existing investments, together with re-investments or follow on investments should be grandfathered.

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

Net assets

No, the financial threshold for the net assets test should not be increased. We acknowledge that the increase in property values has had a significant effect on the number of Australians who may satisfy this test. However, we submit that the appropriate solution would instead be to exclude a person's primary residence from the test. With the exclusion of the primary residence, the threshold for the net assets test will need to be reviewed and reduced accordingly.

We discuss this further in our response to question 3.

Gross Income

No, the financial threshold for gross income in the individual wealth test should not be increased. While we acknowledge that the number of Australians with this level of gross income has increased since the

[1] Based on Australian Bureau of Statistics, Average Weekly Earnings, Australia, Reference period May 2023, Released 17 August 2023

threshold was first set, an income of $250,000 represents more than 2.5 times the full time adult average total earnings[2]. Further, the amount of $250,000 is similar to the equivalent tests in the United States and United Kingdom.

We note that, given the gender pay gap, this amount already discriminates against women and other minorities, who have a lower average income, and are less likely to meet this threshold. Any increase in the limit will further disadvantage women and other minorities, reducing their ability to access wholesale investments in startups, emerging venture capital funds, angel investor syndicates and entrepreneurial businesses. This leads to a lessening of diversity in investors for these types of entities and may lead to a reduction in investment in women-led entities, in which women are more likely to invest. We believe a reduction in the diversity of investors will only serve to broaden the gender wealth gap in Australia.

Further, the test discriminates against investors who have taken extended periods of parental, carer, or other leave. As the gross income threshold must be satisfied for a period of at least two financial years, women, who generally take a longer period of parental leave, may be significantly disadvantaged. For example, having met the threshold in FY 1, a woman who takes parental leave in FY 2 and returns to work at the commencement of FY 3, may then fail to qualify as a wholesale investor until FY 5, being denied access for three years. If the parental leave spans the year end between FY 2 and FY 3, she may fail to qualify as a wholesale investor until FY 6, being denied access for four years. Adjustments should be made to the test to ensure that women who return to the workforce in such circumstances are not unfairly disadvantaged.

<u>Review</u>

The net asset and gross income thresholds should be subject to periodic review to ensure they remain relevant. We are not in favour of annual CPI increases as this will add unnecessary complexity.

If a change to either threshold were to be introduced, investors who satisfy the current thresholds, together with their existing investments (including re-investments or follow on investments), should be grandfathered.

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

Yes, a person's primary residence should be excluded when determining net assets for the purpose of the individual wealth test.

The exclusion of the primary residence would be in line with the tests applied in the United States and the United Kingdom. It recognises that the ownership of a primary residence differs to investment for the purpose of financial gain, and that a primary residence should not be unduly put at risk.

However, with the exclusion of the primary residence, the threshold for the net assets test will need to be reviewed and reduced accordingly[3]. Without a reduction in the threshold, the Australian test will be significantly out of line with the equivalent tests applied in the United States and the United Kingdom.

The threshold should be subject to periodic review to ensure it remains relevant. We are not in favour of annual CPI increases as this will add unnecessary complexity.

If a change to the threshold were to be introduced, investors who satisfy the current thresholds, together with their existing investments (including re-investments or follow on investments), should be grandfathered.

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[2] Based on Australian Bureau of Statistics, Average Weekly Earnings, Australia, Reference period May 2023, Released 17 August 2023

[3] The mean price of residential dwellings in Australia being $925,400 in the September 2023 quarter. Australian Bureau of Statistics, Total Value of Dwellings, Reference period September Quarter 2023, Released 5 December 2023

Contacts

Thank you for your consideration. Please contact us at the details below if you require further information on the matters covered by these joint submissions.

Yours sincerely

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