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REVIEW OF THE REGULATORY FRAMEWORK FOR MANAGED INVESTMENT SCHEMES

Consultation paper, August 2023

Submission

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Introduction

About McMahon Clarke

McMahon Clarke is nationally recognised as a market leader in the Real Estate and Funds Management industries. We bring together specialist skills across our selected focus areas so our clients can create wealth, build successful businesses and manage risk.

We have seven partners and a total complement of 30 staff. Our practice is nationwide, and we proudly celebrate almost 30 years in business. Our strength is underpinned by the calibre of our people which sees our firm consistently ranked as leaders in investment funds and real estate Australia-wide (Chambers Asia Pacific).

We advise responsible entities and promoters of managed funds throughout Australia, as well as investment managers, platform operators, brokers, custodians, advisers, and other stakeholders in the financial services sector.

We have established funds across a variety of asset classes, including property, debt, listed equities, agribusiness, mortgages, and alternative asset schemes. We are industry pioneers, registering the first managed investment scheme in Australia, acting on hundreds of public offers, and being instrumental in key industry bodies such as the Property Funds Association and the Property Council of Australia. In addition, we assisted the first person in Australia to be authorised to operate a corporate collective investment vehicle (CCIV) as corporate director, and worked with the same client in making the first public offer for investment in a CCIV in Australia.

From 1 November 2023, we are joining forces with leading independent Australian law firm Hall & Wilcox.

Review of the regulatory framework for managed investment schemes

We welcome the opportunity to be able to provide a submission with respect to the consultation paper published by Treasury in August 2023. We have set out in this document submissions in relation to each question asked by Treasury. Please note, we have had the benefit of reviewing advanced drafts of the submission to be made by the Financial Services Council (FSC), and our responses to certain questions posed by Treasury confirm our alignment with the views of the FSC.

Contact

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Elliott focuses on all facets of funds management and financial services compliance and advises national and international financial services groups, as well as both new entrants and established industry participants.

Interpretation

In this submission, a reference to the "Act" is a reference to the *Corporations Act 2001* (Cth), and a reference to the "Regulations" is a reference to the *Corporations Regulations 2001* (Cth).

Foreign laws

This submission makes references to the laws of foreign jurisdictions, including the United States of America, the United Kingdom, the Republic of Singapore (Singapore), New Zealand, Hong Kong, and Canada. Please note we are not experts in the laws of foreign jurisdictions and McMahon Clarke is not a global firm, and as such references to the laws of foreign jurisdictions should be construed as illustrative or indicative only.

Chapter 1—Wholesale client thresholds

1. Questions addressed

This part contains submissions in response to the following questions:

(a) Question 1—*Should the financial threshold for the product value test be increased? If so, increased to what value and why?*

(b) Question 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?*

(c) Question 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?*

(d) Question 4—*If consent requirements were to be introduced:*

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

(ii) 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?

2. Introduction

The Act differentiates between retail and wholesale clients, with people being treated as a retail client unless the Act provides otherwise.[1] The majority of consumer protections in the Act only apply to retail clients. The distinction in the treatment of retail clients and wholesale clients purportedly recognises that wholesale clients are people that do not require the same level of protection as retail clients as they are better informed and better able to assess the risks involved in financial transactions.[2]

At the time of the enactment of the *Financial Services Reform Act 2001* (Cth) (FSRA), the significance of being treated as a wholesale client as opposed to a retail client was less than it is today. The revised explanatory memorandum to the *Financial Services Bill 2001* (Cth) notes additional protections are afforded to retail clients in the form of—

(a) the Financial Services Guide

(b) the Statement of Advice

[1] Subsection 761G(1) of the Act.

[2] Paragraph 2.25 of the revised explanatory memorandum to the *Financial Services Reform Bill 2001* (Cth) (FSRB).

(c) the Product Disclosure Statement, and

(d) compensation and complaint handling arrangements.[3]

Since then, significant reform has taken place with respect to retail client protection, including through the introduction of the design and distribution obligations and the implementation of changes as part of the "Future of Financial Advice" (FOFA) reforms. As such, people are "giving up" a lot more now than they used to by being treated as a wholesale client. In this context, and in the context of the increase in the number of Australians that now qualify as a wholesale client since the tests were introduced,[4] there is merit in revisiting and revising the wholesale client tests that are currently in force to ensure the policy objective is maintained, given they have remained unchanged for more than 20 years.[5]

3. Approach to reform

Aside from the questions regarding the introduction of a consent requirement, the questions posed by Treasury with respect to the wholesale client tests relate solely to the "product value test"[6] and the "individual wealth test".[7] The product value test and the individual wealth test are only two of the "general tests"[8] pursuant to which a person may qualify as a wholesale client. Aside from special rules that relate to certain financial products and financial services, a person will also be provided a financial product or a financial service as a wholesale client if they satisfy one of the following other general tests:

(a) Small business test.[9]

[3] See paragraph 6.16 of the revised explanatory memorandum to the FSRB.

[4] We note in the consultation paper Treasury cited research conducted by Associate Professor Ben Phillips from the Australian National University estimated that in 2021, 16 per cent of Australian adults met the individual wealth thresholds to be classified as a wholesale client, compared to 2 per cent of Australian adults in 2002.

[5] Except for the introduction of the "sophisticated investor assessment test" by the insertion of section 761GA in the Act pursuant to the *Corporations Legislation Amendment (Simpler Regulatory System) Act 2007* (Cth).

[6] Paragraph 761G(7)(a) of the Act.

[7] Paragraph 761G(7)(c) of the Act. Despite this test being described as the "individual wealth test", the relevant test refers to a "person", which captures both individuals and companies, and certain partnerships and trusteeships (refer to the definition of "person" in section 761A of the Act).

[8] Being those tests contained in subsection 761G(7) and section 761GA of the Act.

[9] Paragraph 761G(7)(b) of the Act.

(b) Controlled entity test.[10]

(c) Professional investor test.[11]

(d) Sophisticated investor assessment test.[12]

(e) Related bodies corporate test.[13]

We consider a holistic view should be taken when considering reform to the wholesale client tests, with regard being had to all the general tests contained in the Act when making a policy decision as to reform. We do not consider the financial thresholds for the product value test and the individual wealth test should be considered and reviewed without having regard to the other tests.

4. No changes for certain tests

We broadly do not consider any reform is required with respect to the small business test, the controlled entity test, the professional investor test, or the related bodies corporate test.

It would be helpful if the controlled entity test were clarified as to its application to “trusts”. We note regulation 7.6.02AB of the Regulations inserts the following paragraph into subsection 761G(7) of the Act:

> *“(ca) the financial product, or the financial service, is acquired by a company or trust controlled by a person who meets the requirements of subparagraph (c)(i) or (ii);"*

We consider the reference to the acquisition of a financial product by a “trust” to be problematic given a trust is not a person. We consider the operation of regulation 7.6.02AB of the Regulations could be clarified by including reference to the acquisition of a product by the trustee of a trust, where the relevant trust is controlled by a person who meets the individual wealth test.

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[10] Paragraph 761G(7)(ca) of the Act, as inserted by regulation 7.6.02AB of the Regulations. This test is rarely referred to separately from the individual wealth test. Essentially, a company or “trust” controlled by a person who meets the individual wealth test is taken to be a wholesale client.

[11] Paragraph 761G(7)(d) of the Act

[12] Section 761GA of the Act. We refer to this test as the “sophisticated investor assessment test” to avoid confusion with the reference to “sophisticated investors” in section 708 of the Act.

[13] Subsection 761G(4A) of the Act, as inserted by regulation 7.6.02AD of the Regulations. This test is rarely referred to as a “wholesale client test”. Essentially, a financial product or service provided to a related body corporate of a person who is a wholesale client is taken to be a wholesale client.

It would also be helpful if the controlled entity test were revised to also apply to entities controlled by a person who is a wholesale client generally, as opposed to only applying to entities controlled by a person who meets the individual wealth test. This would, among other things, enable a product issuer to treat a particular company as a wholesale client if the company is controlled by a person who meets the sophisticated investor assessment test.

The following wording is proposed having regard to the above:

> *"(ca) the financial product, or the financial service, is acquired by:*
>
> *(i) a company that is controlled by a person who is a wholesale client; or*
>
> *(ii) in relation to a trust controlled by a person who is a wholesale client--the trustee of the trust;"*

5. Revision of the financial thresholds for the individual wealth test

5.1 Introduction

The financial thresholds for the individual wealth test were set some time ago, with the commencement date of the FSRA being 11 March 2002. A lot of time has passed since then, and they are due for revision.

When approaching the revision of the financial thresholds, Treasury may approach it in two ways: one with limited considerations, and one with many considerations.

5.2 Limited considerations revision

If Treasury were to seek to revise the financial thresholds with limited considerations, then the numbers would simply be revised having regard to one or more of the following:

(a) Adjustment based on inflation since the commencement of the FSRA.

(b) Adjustment based on the growth in the total earnings of Australians since the commencement of the FSRA.

(c) Adjustment to capture the same proportion of Australians now as the tests did in 2002, assuming there were valid reasons to only capture that percentage of Australians when the tests were set.

With respect to paragraphs 5.2(a) and 5.2(b) above, the following table sets out how the financial thresholds may be revised:

Threshold	Inflation adjustment[14]	Average total earnings adjustment[15]
$250,000	$414,000	$523,000
$2,500,000	$4,141,000	$5,235,000

Please note, the above should be considered indicative only of the adjustment to values having regard to inflation and total earnings. We also note changes to "average" total earnings for Australian full-time workers over the relevant period is distorting because it does not take into account any asymmetry of distribution of incomes in Australia. Instead, we consider any adjustment based on total earnings should use "median" total earnings to analyse the change in total earnings over the relevant period, otherwise the revision of the financial thresholds may capture fewer individuals than intended.

If a limited consideration revision of the financial thresholds was to be pursued by Treasury, then we submit the revision should align with paragraph 5.2(c) above, as opposed to paragraphs 5.2(a) and 5.2(b). Revision based on inflation or total earnings will not necessarily result in an appropriate proportion of Australians being captured by the tests. Such a revision may, without merit, substantially reduce the number of Australians who qualify as wholesale clients, even below that proportion of Australians who qualified as wholesale clients under the individual wealth test in 2002.

We submit Treasury ought not to adopt a "limited consideration revision" of the financial thresholds for the individual wealth test. Revising the tests having regard only to the matters set out in paragraphs 5.2(a), 5.2(b) and 5.2(c) will not account for the increase in sophistication of Australians since the FSRA commenced. We do not consider such a revision of the tests will accurately implement the policy objective of identifying those Australians that do not require the same level of protection as retail clients. Australians are more sophisticated now than they were more than 20 years ago.

[14] Calculated as the change in cost of purchasing a representative 'basket of goods and services' over the period 2002 to 2022 using the Reserve Bank of Australia's inflation calculator, accessible at https://www.rba.gov.au/calculator/, and rounded to the nearest $1,000.

[15] Calculated using Australian Bureau of Statistics, Average Weekly Earnings, Australia, February 2002 6302.0 (link) and the Australian Bureau of Statistics, Average Weekly earnings, Australia, November 2022 (link). We took the full time adult average weekly earnings from each report ($897.30 and $1,878.50, respectively), multiplied them by 52, and then adjusted the financial threshold to take into account the growth in full time adult average weekly earnings, and rounded the numbers to the nearest $1,000.

5.3 Multiple considerations revision

Rather than implementing a limited consideration revision, we submit Treasury ought to undertake the exercise contemplated below in seeking to revise the financial thresholds for the individual wealth test, so that the new thresholds are appropriate in the current Australian landscape. The first step would be for Treasury to determine the proportion of Australians Treasury considers are sufficiently sophisticated such that they do not require the same level of protection as retail clients. The second step would be for Treasury to consider financial data around total earnings of Australians and their net assets, so that the corresponding value of gross income and net assets can be determined that would mean the same proportion of Australians are captured as those considered to be sophisticated pursuant to step 1.

Treasury should also have regard to the disruption that would be caused by significantly increasing the financial thresholds, such that a far greater proportion of Australians would be treated as retail clients. A substantial revision would have a significant effect on the ability of product issuers to structure wholesale products and would reduce the level of innovation within the Australian financial services industry.[16]A significant revision of the financial thresholds would also reduce competition, noting the retail funds management space is highly concentrated.[17] A significant revision would also require otherwise sophisticated Australians to invest in products that do afford protection as retail clients even if they do not require such protection, and such products may not necessarily aligning with their investment profile.

5.4 Step 1: Determination of proportion of Australians that are sophisticated

(a) Introduction

The first step in the process we consider Treasury should adopt in revising the financial thresholds for the individual wealth test is to determine the proportion of Australians that can be considered to be “sophisticated”.

The base case would be that at least 2 percent of Australians are sophisticated, based on the research cited by Treasury in the consultation paper and on the assumption—

(i) there were valid reasons to only capture that percentage of Australians when the tests were set, and

(ii) the relative sophistication of Australians has not declined in the last 20 years.

[16] Given the regulatory costs involved in offering financial products and services to retail clients, often new products and services are created and tested in the wholesale client market first, and then offered to retail clients later.

[17] It is noted by Treasury in the consultation paper that 10 responsible entities operate 46 percent of all registered schemes.

The next step in the process would be to consider a range of factors relevant to assessing financial sophistication, and adjusting this base rate accordingly so that an appropriate proportion of Australians are identified as being sophisticated. Some of those relevant factors are set out below, but they are by no means exhaustive of the factors Treasury ought to have regard. We consider the factors Treasury should have regard should at least include those factors that would increase the likelihood of a person being assessed as being a wholesale client pursuant to the sophisticated investor assessment test, or factors Treasury considers an AFS licensee could have regard to when utilising the test. That is, the experience people have in investing in financial products, and factors that have a bearing on a person's ability to assess the merits and value of financial products and services, the risks associated with holding the financial products, their own information needs, and the adequacy of the information given by the relevant person.

(b) Tertiary education

In 2022, 28.8 percent of males and 35.2 percent of females held a bachelor degree or above as their highest qualification.[18] This is a marked increase from the position in 2002, where only 17.8 percent of persons had a bachelor degree or above as their highest qualification.[19] University education is strongly associated with financial literacy.[20] We consider the holding of tertiary qualifications is indicative of a person's ability to assess the merits and value of financial products and services, the risks associated with holding the financial products, source their own information and undertake their own assessment of a product, and to assess the adequacy of the information given by the relevant person.

We consider this factor supports the proposition more Australians should now be captured by the individual wealth test than the 2 percent that were captured in 2002.

(c) Access to information

Through the continued expansion of the internet, information is more accessible to people now than has ever been the case in history. This means people are better positioned now than they were when the financial thresholds were first set to assess and compare products, source their own

[18] Australian Bureau of Statistics (2022, May), Education and Work, Australia, ABS Website, accessed 24 September 2023 (link).

[19] Australian Bureau of Statistics (2002, May), 6227.0 - Education and Work, Australia. ABS Website, accessed 24 September 2023 (link).

[20] Melbourne Institute, Applied Economic & Social Research, "The Household, Income and Labour Dynamics in Australia Survey: Selected Findings from Waves 1 to 20", 2022, page 64.

information and undertake their own research, and understand the risks and merits of particular financial products.

We consider this factor supports the proposition more Australians should now be captured by the individual wealth test than the 2 percent that were captured in 2002.

(d) Access to advice

The means of a person to acquire appropriate advice has been cited as a reason certain people do not require the same level of protection as retail clients.[21]

It has been estimated approximately 10 percent of people have access to financial advice.[22] While we are not able to cite data in support of this proposition, we expect this proportion is greater than what was the case in 2002. If the same rationale were adopted now as was adopted when the financial thresholds were set, then it would be considered appropriate that a greater percentage of Australians are “sophisticated” than was the case in 2002. In fact, it could be argued 10 percent of Australians are sophisticated.

We consider this factor supports the proposition more Australians should now be captured by the individual wealth test than the 2 percent that were captured in 2002.

(e) Increased ownership of financial affairs

Regard needs to be had to the fact many Australians actively manage their superannuation savings through self-managed superannuation funds (SMSFs), and through that management have acquired considerable levels of financial literacy.

The Australian Taxation Office has reported there were 1.123 million SMSF members in Australia as at 30 June 2022.[23] We consider members of SMSFs are more likely than the general population to be financially sophisticated, not just because of their access to advice,[24] but by virtue of their making of investment decisions as part of the operation of an SMSF.

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[21] See paragraphs 6.27 and 6.32 of the revised explanatory memorandum to the FSRB.

[22] Association of Financial Advisers Ltd, Submission to Treasury in response to the Quality of Advice Review – Issues Paper, 10 June 2022.

[23] Australian Taxation Office, Self-managed super funds: A statistical overview 2020-21, Member profile (link).

[24] We note financial, legal and accounting advice is often received in the establishment and operation of an SMSF.

At 30 June 2021, SMSFs held—

(i) 25 percent of their assets in indirect investments (trusts and managed investments), and

(ii) 47 percent of their assets in either Australian listed shares or cash and term deposits.[25]

At 30 June 2021, 75 percent of all SMSF assets are held in one of the following five investments: [26]

(i) Australian listed shares.

(ii) Cash and term deposits.

(iii) Listed trusts.

(iv) Unlisted trusts.

(v) Non-residential real property.

The above means a large proportion of Australian investors are regularly assessing the merits and values of financial products and services, particularly interests in listed and unlisted managed investment schemes, and in doing so increasing their investment experience and financial literacy. A large number of investors in wholesale managed investment schemes are SMSFs.

It is also estimated more than half the Australian adult population now hold investments other than their family home and superannuation holdings.[27]

We consider this factor supports the proposition more Australians should now be captured by the individual wealth test than the 2 percent that were captured in 2002.

5.5 Step 2: Mapping against financial metrics

Once Treasury has determined the appropriate proportion of Australians that can be considered "sophisticated" and therefore ought to be captured by the individual wealth test, the second step in the process we consider Treasury should adopt in revising the financial thresholds is to review financial data or commission research to determine the appropriate thresholds that would capture

[25] Australian Taxation Office, Self-managed super funds: A statistical overview 2020-21, Investment profile (link).

[26] Australian Taxation Office, Self-managed super funds: A statistical overview 2020-21, Investment profile (link).

[27] Australian Securities Exchange, ASX Australian Investor Study 2023 (link).

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the same proportion of Australians that can be considered to be "sophisticated". Treasury could commission research of a similar kind to that cited by Treasury in the consultation paper to determine the relevant values for the individual wealth test such that the appropriate proportion of Australians are captured. This would likely result in gross income and net asset thresholds that are much different to those that would be determined if the current thresholds were simply adjusted to account for inflation and growth in total earnings.

5.6 Conclusion

While we do not necessarily consider 16 percent of Australians ought to be captured as satisfying the individual wealth test, we consider a significantly greater proportion of Australians are now sophisticated than was the case in 2002. While we have no compelling reason to think this is the case, we consider it would be appropriate to revise the financial thresholds for the individual wealth test to capture closer to 10 percent of Australians.

6. **Individual wealth test**

6.1 The test and rationale

Subsection 761G(7) of the Act provides, among other things and in summary, a person will be a "wholesale client" in relation to certain products and services if the person who acquires the product or service gives the provider a copy of a certificate given within the preceding two years by a qualified accountant that states the person—

(a) has net assets of at least $2,500,000, or

(b) has a gross income for each of the last two financial years of at least $250,000.[28]

In the context of the above test, it was noted that "wealthy individuals" may, by virtue of the individual wealth test, choose to decline the retail protections, presumably on the basis they either have considerable experience in making investments or have the means to seek appropriate advice.[29]

6.2 Appropriateness of revision and approach to be taken

As noted above, there is merit in revisiting and revising the wholesale client tests currently in force to ensure the policy objective is maintained, given they have

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[28] See paragraph 761G(7)(c) of the Act and regulations 7.1.28 and 7.6.02AF of the Regulations. The test also captures the net assets and gross income of a company or trust controlled by the person: see regulation 7.6.02AC of the Regulations.

[29] See paragraph 6.32 of the revised explanatory memorandum to the FSRB.

remained unchanged for more than 20 years.[30] The financial thresholds ought to be reconsidered in the context of the time that has passed since the enactment of the FSRA.

As noted above, we submit Treasury ought to undertake the exercise contemplated in section 5.3 (the "multiple considerations revision") in analysing and revising the financial thresholds for the individual wealth test.

6.3 Gross income limb

In terms of international equivalents, the following table summarises the position in certain other jurisdictions with reference to the "gross income limb" of the individual wealth test.

Jurisdiction	Financial threshold[31]	Australian dollar equivalent[32]
Singapore[33]	$300,000	$342,000
United States of America[34]	$200,000 (individual) or $300,000 (joint income with spouse)	$311,000 and $467,000, respectively
Canada[35]	$200,000 (individual) or $300,000 (joint income with spouse)	$231,000 and $347,000, respectively

We understand there is no equivalent of the gross income limb of the individual wealth test in New Zealand, the United Kingdom, or Hong Kong.

[30] Except for the introduction of the "sophisticated investor assessment test" by the insertion of section 761GA in the Act pursuant to the *Corporations Legislation Amendment (Simpler Regulatory System) Act 2007* (Cth).

[31] Expressed in the local currency of the relevant jurisdiction.

[32] The approximate conversion of the relevant currency to Australian dollars as at the date of this submission, rounded to the nearest $1,000.

[33] A person will be an "accredited investor" if they meet this test. See paragraph 4A(1)(a) of the *Securities and Futures Act 2001* (Singapore).

[34] A person will be an "accredited investor" if they meet this test. The term "accredited investor" is defined in § 230.501(a) of Regulation D of the *Securities Act of 1933, 17 C.F.R.* (United States of America).

[35] A person will be an "accredited investor" if they meet this test. See section 1.1 of the National Instrument 45-106 *Prospectus Exemptions, BC Reg 227/2009* (Canada).

6.4 Net assets limb

In terms of international equivalents of the "net assets limb" of the individual wealth test, the following table summarises the position in certain other jurisdictions, including any restrictions placed on the net assets tests (such as the exclusion of the family home, or inclusion of only certain assets, when undertaking the calculation).

Jurisdiction	Restrictions	Financial threshold[36]	Australian dollar equivalent[37]
Singapore—test 1[38]	Contribution of the individual's primary residence taken to be the lower of— • the estimated fair market value of the residence less any secured debt, and • $1 million. [39]	$2 million	$2,273,000
Singapore—test 2[40]	"Financial assets" only—bank accounts, securities, units in a collective investment scheme, derivatives contracts, spot foreign exchange contracts, life policy, and such other products as may be prescribed.[41]	$1 million	$1,137,000
Canada—	Unrestricted	$5 million	$5,761,000

[36] Expressed in the local currency of the relevant jurisdiction.

[37] The approximate conversion of the relevant currency to Australian dollars as at the date of this submission, rounded to the nearest $1,000.

[38] A person will be an "accredited investor" if they meet this test. See section 4A of the *Securities and Futures Act 2001* (Singapore).

[39] See subsection 4A(1A) of the *Securities and Futures Act 2001* (Singapore).

[40] A person will be an "accredited investor" if they meet this test. See section 4A of the *Securities and Futures Act 2001* (Singapore).

[41] See subsection 4A(1)(a)(i)(B) of the *Securities and Futures Act 2001* (Singapore).

Jurisdiction	Restrictions	Financial threshold[36]	Australian dollar equivalent[37]
test 1[42]			
Canada—test 2[43]	"Financial assets" only—cash, securities, contract of insurance, a deposit or an evidence of a deposit that is not a security.[44]	$1 million	$1,152,000
United States of America—test 1[45]	A person's primary residence is not included, nor is any debt secured against the primary residence (except any amount of debt that exceeds the estimated market value of the primary residence)	$1 million	$1,553,000
United States of America—test 2[46]	"Investments" only—as defined by the Securities and Exchange Commission, which can include securities, real estate held for investment purposes (not a primary residence), commodities and cash and cash equivalents held for investment purposes.[47]	$5 million	$7,764,000

[42] A person will be an "accredited investor" if they meet this test. See section 1.1 of the National Instrument 45-106 *Prospectus Exemptions, BC Reg 227/2009* (Canada).

[43] A person will be an "accredited investor" if they meet this test. See section 1.1 of the National Instrument 45-106 *Prospectus Exemptions, BC Reg 227/2009* (Canada).

[44] See section 1.1 of the National Instrument 45-106 *Prospectus Exemptions, BC Reg 227/2009* (Canada).

[45] A person will be an "accredited investor" if they meet this test. The term "accredited investor" is defined in § 230.501(a) of Regulation D of the *Securities Act of 1933, 17 C.F.R.* (United States of America).

[46] A person will be a "qualified purchaser" if they meet this test. The term "qualified purchaser" is defined in § 2(a)(51)(A) of the *Investment Company Act of 1940, 15 U.S.C* (United States of America).

[47] See § 270.2a51-1(a) of the Rules and Regulations of the *Investment Company Act of 1940, 17 U.S.C* (United States of America).

Jurisdiction	Restrictions	Financial threshold[36]	Australian dollar equivalent[37]
Hong Kong[48]	“Portfolio”—any securities, certificates of deposit, and money held by a custodian.[49]	$8 million	$1,589,000
New Zealand—test 1[50]	Unrestricted	$5 million	$4,624,000
New Zealand—test 2[51]	“Specified financial products”[52]—financial products other than interests in a retirement scheme, financial products issued by an associated person of the person, and anything else that is prescribed.	$1 million	$925,000
United Kingdom[53]	“Financial instrument portfolio”—cash deposits, transferable securities, money-market securities, units in collective investment undertakings, and certain types of derivatives.	€500,000	$827,000

[48] A person will be a “professional investor” if they meet this test. See section 2 of the *Securities and Futures (Professional Investor) Rules* (Cap. 571D of the laws of Hong Kong).

[49] See Section 2 of the *Securities and Futures (Professional Investor) Rules* (Cap. 571D of the laws of Hong Kong).

[50] A person will be a “wholesale client” and a “wholesale investor” if they meet this test. Paragraph 39(1)(a) of Schedule 1 of the *Financial Markets Conduct Act 2013* (NZ).

[51] A person will be a “wholesale client” and a “wholesale investor” if they meet this test. See paragraph 38(1)(a) of Schedule 1 of the *Financial Markets Conduct Act 2013* (NZ).

[52] See subclause 38(4) of Schedule 1 of the *Financial Markets Conduct Act 2013* (NZ). Specified financial products means financial products other than interests in a retirement scheme, financial products issued by an associated person of the person, and any else that is prescribed.

[53] In order for a person to be a “professional client” under the “elective professional clients” test for a firm covered by the Markets in Financial Instruments Directive, they need to satisfy this test. See Financial Conduct Authority (FCA) (2022), Conduct of Business Source Book (COBS), 3.5.3 Elective professional clients.

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6.5 Exclusion of family home and superannuation

We do not consider the value of a person's primary residence or the value of their superannuation holdings should be entirely removed from the individual wealth test. Doing so would penalise those who made the investment decision to—

(a) acquire their family home, as opposed to renting, and

(b) make additional contributions to their superannuation fund at the expense of investing in other forms of financial assets.

The analysis referred to in section 5.5 above (Step 2: Mapping against financial metrics) should be conducted having regard to the inclusion or exclusion of the value of a person's primary residence and their superannuation holdings, in order for Treasury to make a decision as to how those assets should be treated for the purposes of the individual wealth test. That is to say, if the thresholds are set having regard to a person's net assets, but net assets is calculated taking into account the value of a person's primary residence and their superannuation holding, then an appropriate proportion of Australians would not be captured by the revised test if the tests are framed to exclude those assets.

6.6 Submission

We submit the financial threshold for the "gross income" limb of the individual wealth test should be subject to revision. In revising the financial threshold, we submit Treasury ought to adopt the multiple consideration process set out in section 5.3 of this submission. However, if Treasury were not to adopt the multiple consideration process, then we suspect the appropriate threshold for the gross income limb would be between $250,000 and $300,000.

We submit the "net assets" limb of the individual wealth test should be amended so there are two limbs, as follows:

(a) The "first net assets limb" would capture all assets and liabilities, as is the case for the current individual wealth test. We consider the financial threshold for this limb ought to be increased. In revising the financial threshold, we submit Treasury ought to adopt the multiple consideration process set out in section 5.3 of this submission. However, if Treasury were to adopt a limited consideration revision, then we suspect the appropriate threshold would be between $4 million and $5 million. We note a revision to $5 million would bring Australia more in line with the position in New Zealand, the United States of America,[54] and Canada (disregarding currency differences).

[54] We note the "higher" net assets limb in The United States of America also excludes the value of a persons primary residence.

(b) The "second net assets limb" would not capture all assets and liabilities. It is proposed the second net assets limb capture all assets and liabilities, other than—

(i) the value of the individual's primary residence (and debt secured over the family home), and

(ii) the value of an individual's superannuation holdings.

The above would mean the second net assets limb is effectively focussed on the value of a person's "investment assets" (such as shares or interests in schemes and investment properties) or "investible assets" (such as cash or cash equivalents). It is proposed the value of this second limb be set at $1 million.

The above would align the Australian position with international equivalents. We note New Zealand, the United States of America, Canada, and Singapore all effectively have two different "assets" tests, with a higher one capturing all assets,[55] and a lower one only capturing "financial assets", however described.

6.7 Alignment with Chapter 6D

We consider any change made with respect to the financial thresholds for the individual wealth test (or any other changes to the test) as contained in Chapter 7 of the Act should also be made in relation to the equivalent test in Chapter 6D of the Act.

7. **Product value test**

7.1 The test and rationale

Subsection 761G(7) of the Act provides, among other things and in summary, a person will be a "wholesale client" in relation to certain financial products and financial services if the price for the provision of the financial product or the value of the financial product to which the financial service relates equals or exceeds $500,000.[56] The product value test is based on the assumption persons who can afford to acquire financial products or services with a value above the prescribed amount do not require protection as retail clients as they may be presumed to have either adequate knowledge of the product or service, or the means to acquire appropriate advice.[57]

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[55] We note the "higher" net assets limb in The United States of America also excludes the value of a persons primary residence. We also note in Singapore, only a portion of the value of the family home may be captured.

[56] See paragraph 761G(7)(a) of the Act and regulations 7.1.18 and 7.1.19 of the Regulations.

[57] See paragraph 6.27 of the revised explanatory memorandum to the FSRB.

Of all the wholesale client tests, we consider the product value test to be the least meritorious. This is because of the three thresholds it is the threshold which is most likely to be satisfied by someone who becomes “fortuitously wealthy”. By that we mean those people who sell a single asset which has increased in value over time (such as the family home) or who have received a windfall inheritance. Those people will most likely be able to satisfy the product value threshold before being able to satisfy the individual wealth test.

7.2 Limited application—a “test of convenience”

In our experience, the product value test is most relevant in the context of institutional investment and is not as frequently applied in the broader managed fund space as compared to the individual wealth test. This is because it is not as common for a person to invest at least $500,000 in any one particular product as it is for a person to invest a lower amount. Indeed, often the minimum investment amount in a wholesale managed investment scheme is in the vicinity of $100,000 (or some other amount below $500,000), with such an amount set on the understanding the vast majority of a fund manager’s investor base would rely on the individual wealth test to qualify for investment in the fund.

While a number of investors in our clients’ wholesale funds do make substantial investments (well in excess of $500,000 per investment), we expect the decision to invest such large amounts is based on the merits of the investment opportunity and the alignment of the features of the schemes with their investment profile, and not their desire to satisfy the product value test.

We expect the typical applicant who would invest at least $500,000 in a particular product would ordinarily satisfy another wholesale client test, such as the professional investor test or the individual wealth test (or controlled entity test). In our view, the product value test only has practical utility as a “test of convenience”. That is to say, if you invest a substantial amount of money in a product, then you do not need to concern yourself with obtaining and providing a qualified accountant’s certificate to be treated as a wholesale client, either upfront or on an ongoing basis.[58]

7.3 Issues

A key issue raised in relation to the product value test is it may limit diversification by potentially encouraging investors to invest a substantial proportion of their wealth in a particular product in order to be able to be treated as a wholesale client with respect to that product and therefore be eligible to invest. Another issue with the product value test is it may enable an otherwise “unsophisticated” person to be treated as a wholesale client where they come in to a large amount of money (but not enough to satisfy the individual wealth test), such as a person who has been in receipt of an inheritance.

[58] In order to continue to be treated as a wholesale client, a person needs to obtain and provide updated certificates every two years. We note regulation 7.1.27 of the Regulations only preserves the treatment of a person as a wholesale client if they satisfied the product value test.

7.4 International equivalents

We understand there is an equivalent of the product value test in New Zealand in the context of the disclosure rules. In New Zealand, a person is a “wholesale investor” in relation to an offer of financial products if, among other things, the minimum amount payable by the person on acceptance of the offer is at least $750,000.[59] In relation to an offer for a derivative for issue or sale, a person is a “wholesale investor” if the notional value of the derivative is at least $5 million.[60]

In terms of Australian dollars, $750,000 New Zealand dollars equates to roughly $690,000, and $5 million New Zealand dollars equates to roughly $4.6 million Australian dollars, as at the date of this submission.

We understand there is no equivalent of the product value test in the United States of America, the United Kingdom, Singapore, Hong Kong or Canada.

7.5 Solution and submission

We note if the financial threshold for the product value test were revised to take account for—

(a) inflation, the relevant amount would be $828,000[61] and

(b) average total earnings for full time workers, the relevant amount would be $1,047,000.[62]

We consider the issues identified in section 7.3 may be resolved by aligning the monetary threshold for the product value test with the monetary threshold for our proposed “second net assets limb” of the individual wealth test. As noted in section 6.6, we submit a second net assets limb should be introduced which would not capture all assets and liabilities of an individual but would effectively only capture their “investment assets” and “investible assets”. In this context, we consider it would be reasonable to increase the financial threshold for the product value test to $1 million. We note this is the value suggested by Treasury in its January 2011 options paper regarding wholesale and retail clients in the context

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[59] See paragraph 3(3)(b) of Schedule 1 of the *Financial Markets Conduct Act 2013* (NZ).

[60] See paragraph 3(3)(c) of Schedule 1 of the *Financial Markets Conduct Act 2013* (NZ).

[61] Calculated as the change in cost of purchasing a representative ‘basket of goods and services’ over the period 2002 to 2022 using the Reserve Bank of Australia’s inflation calculator, accessible at https://www.rba.gov.au/calculator/, and rounded to the nearest $1,000.

[62] Calculated using Australian Bureau of Statistics, Average Weekly Earnings, Australia, February 2002 6302.0 (link) and the Australian Bureau of Statistics, Average Weekly earnings, Australia, November 2022 (link). We took the full time adult average weekly earnings from each report ($897.30 and $1,878.50, respectively), multiplied them by 52, and then adjusted the financial threshold to take into account the growth in full time adult average weekly earnings, and rounded the numbers to the nearest $1,000.

of the future of financial advice reforms. This value aligns with our proposed "second net assets limb" in relation to the individual wealth test, where a person may satisfy that test if they have at least $1 million in "investment assets" and "investible assets".

Aligning the monetary threshold for the product value test with the monetary threshold for our proposed second net assets limb would mean a person positioned to satisfy the product value test (by having sufficient cash on hand to make the requisite investment) would also satisfy the individual wealth test, which would enable them to be treated as a wholesale client without needing to put "all their eggs in one basket". Our intention in submitting the product value test should align with the "second net assets limb" is that it ought to be the position that a person who is positioned to satisfy the product value test also satisfy the individual wealth test, such that they are not motivated to invest a large amount just to qualify as a wholesale client, but would rather invest an amount they consider appropriate having regard to the merits of the investment opportunity, the alignment of the features of the scheme with their investment profile, and what they consider to be the appropriate proportion of their investment portfolio that should be invested in the relevant product.

If the financial threshold for the product value test were increased and our submission on the introduction of the second net assets limb were not adopted (or our submission that the threshold for the product value test should align with the threshold for that limb), then the concerns outlined in section 7.3 would only be exacerbated.

The revision of the financial thresholds for the product value test we propose would also mean the product value test would continue to generally be relied on by institutional investors that wish to use the test as a "test of convenience".

We do not consider a "revision up" of the financial threshold for the product value test as contemplated in this submission would result in material disruption to industry, having regard to its limited use relative to the individual wealth test.

7.6 Alignment with Chapter 6D

We consider any change made with respect to the financial threshold for the product value test (or to the test itself) as contained in Chapter 7 of the Act should also be made in relation to the equivalent test in Chapter 6D of the Act.

8. Sophisticated investor assessment test

8.1 The test and rationale

Section 761GA of the Act effectively provides a financial product or financial service (other than certain financial products or financial service) is provided by an AFS licensee to another person as a wholesale client if the financial product or service is not provided for use in connection with a business, and the licensee is satisfied on reasonable grounds that the person has previous experience in using financial services and investing in financial products that allows them to assess—

(a) the merits of the product or service

(b) the value of the product or service

(c) the risks associated with holding the product

(d) their own information needs, and

(e) the adequacy of the information given by the licensee and the product issuer.

Further, in order to treat the person as a wholesale client, the licensee must give the person a written statement of their reasons for being satisfied as to the above matters, and the person must sign a written acknowledgment that—

(a) the licensee has not given them a Product Disclosure Statement or any other document that would be required to be given to them under Chapter 7 of the Act if the product or service were provided to them as a retail client, and

(b) the licensee does not have any other obligation to the client under Chapter 7 of the Act that they would have if the product or service were provided to them as a retail client.

The rationale behind the introduction of the test is that there may be people who are sufficiently informed and understand the risks involved such that they do not require the same level of protection as retail clients, notwithstanding they may not satisfy one of the other tests (such as the individual wealth test).

8.2 The issues

The sophisticated investor assessment test is not widely used, at least not in the funds management space. While we are not aware of any case law to validate this concern, a key concern of AFS licensees is the ability for their assessment to potentially be challenged. A client may assert they ought never have been assessed and subsequently treated as being a wholesale client, and could contend the licensee could not have had “reasonable grounds” to satisfy themselves for the relevant things. The assessment is inherently subjective and, in this sense, may be open to challenge, and the concern is therefore valid.

Further, another reason the sophisticated investor assessment test is not widely used in the funds management space is by virtue of the nature of the relationship between a fund manager and their clients. It is generally not the case that fund managers know their clients' personal circumstances to a sufficient degree that affords them the capability of satisfying themselves on reasonable grounds that the client has the requisite experience and knowledge. Fund managers are generally only authorised to provide general advice and as such are not accustomed to learning a client's particular circumstances as part of the carrying on of their business. There are other service providers that may be better placed to make this assessment than the product issuer, such as financial advisers and accountants.

8.3 Most meritorious

The sophisticated investor assessment test is almost inarguably the test that is most consistent with the underlying policy rationale of the different treatment of retail clients and wholesale clients. The policy rationale is that wholesale clients are better informed and better able to assess the risks involved in financial transactions, and as such do not require the same level of protection as retail clients.[63] The sophisticated investor assessment test actually "tests" this sophistication, whereas—

(a) the individual wealth test and the product value test use monetary amounts as a means of presuming sophistication or the ability to access advice,[64] and

(b) the professional investor test presumes certain entities by their nature have the expertise or access to professional advice to justify their being treated as wholesale.[65]

As we consider the sophisticated investor assessment test to be the most meritorious of the wholesale client tests, we consider any reform of the wholesale client tests should seek to achieve the increased use of the sophisticated investor assessment test.

8.4 The solution: self-certification accompanied by professional advice

We consider there would be greater uptake of the test if the onus of certification is placed on the person that seeks to be treated as a wholesale client, and not the AFS licensee. We do consider, however, certain safeguards need to be in place, as otherwise the test may be abused.

[63] Paragraph 2.25 of the revised explanatory memorandum to the FSRB.

[64] See paragraphs 6.27 and 6.32 of the revised explanatory memorandum to the FSRB.

[65] See paragraph 2.28 of the revised explanatory memorandum to the FSRB.

In New Zealand, a person can "self-certify" themselves as being an "eligible investor" (which is a type of "wholesale investor" and "wholesale client"). In relation to an offer of financial products, a person is an eligible investor if—[66]

(a) the person certifies in writing that they have previous experience in acquiring or disposing of financial products that allows them to assess—

(i) the merits of the transaction (including assessing the value and the risks of the financial products involved)

(ii) their own information needs in relation to the transaction, and

(iii) the adequacy of the information provided by any person involved in the transaction

(b) the person certifies in writing that they understand the consequences of certifying themself to be an eligible investor

(c) the person states in the certificate the grounds for this certification, and

(d) a financial adviser, a qualified statutory accountant, or a lawyer signs a written confirmation of the certification.

A financial adviser, a qualified statutory accountant, or a lawyer is prohibited from confirming such a certification unless they, having considered the person's grounds for the certification—

(a) are satisfied that the person has been sufficiently advised of the consequences of the certification, and

(b) have no reason to believe that the certification is incorrect or that further information or investigation is required as to whether or not the certification is correct.

We consider the sophisticated investor assessment test as contained in section 761GA of the Act should be revised to more closely align with the self-certification model in place in New Zealand. We submit the sophisticated investor assessment test ought to be amended to provide for the following:

(a) The person that seeks to be treated as a wholesale client be the person that completes and provides the certificate.

(b) In completing the certificate, the person specifies the grounds upon which they consider they are sophisticated, with reference to the factors currently specified in section 761GA of the Act.

(c) The certificate cover entities controlled by the individual.[67]

[66] Clause 41 of Schedule 1 of the *Financial Markets Conduct Act 2013* (New Zealand).

(d) The certificate be provided in relation to a class of financial products (such as interests in managed investment schemes) and not be confined to a particular offer, such that it can be relied on in more than one instance.

(e) The certificate be valid for a period of two years, such that the person may acquire interests in a number of schemes in reliance on the certificate over that period of time.

(f) The certificate be signed by a financial adviser, qualified accountant or lawyer, and in doing so they confirm the person providing the certificate has been sufficiently advised of the consequences of the certification and that they have no reason to believe that the information contained in the certificate is incorrect.

We consider the amendment of the sophisticated investor assessment test as submitted above would considerably increase reliance on the sophisticated investor assessment test by product issuers. We consider the amendment is also consistent with policy, and would promote investor freedom and allow investors to take ownership of their financial affairs and assist in their building of an investment portfolio that is appropriate for them having regard to, among other things, their risk profile.

8.5 Alternate solution – reliance by others on certificate provided

If our above recommendation is not adopted, then an alternative way the sophisticated investor assessment test may be revised to increase its use in the funds management space would be to modify the test such that—

(a) an AFS licensee can rely on the assessment undertaken by another AFS licensee

(b) the certificate can be provided in relation to a class of financial products (such as interests in managed investment schemes) and not be confined to a particular offer, such that it can be relied on in more than one instance, and

(c) the certificate be valid for a period of two years, such that the person may acquire interests in a number of schemes in reliance on the certificate over that period of time.

The above would resolve the issue presented by the nature of the relationship between a product issuer and their clients, but may still result in the test not being widely used, as the other licensee (such as a financial adviser) may not be comfortable providing a certification having regard to liability concerns. In this regard, the amendment we propose in section 8.4 is preferable.

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[67] We note this element would not be necessary if the controlled entity test were amended as submitted by us in section 4.

8.6 Alternate and additional solution – “safe harbour”

Whether or not any of our above solutions are adopted, we consider a “safe harbour” mechanism should be implemented with respect to the sophisticated investor assessment test, which would operate to provide certainty to an AFS licensee as to the effect of their assessment (or the assessment undertaken by the relevant person). Such a mechanism could be similar to the equivalent in New Zealand (refer to section 9.2 below) and should be designed to alleviate concerns as to an assessment being subject to challenge.

8.7 Tweaks if the test were to remain the same

If our above submissions are not adopted or implemented, then we consider some minor tweaks should be made to section 761GA of the Act, namely:

(a) Subparagraph 761GA(d)(v) of the Act should be amended to include the words “(if relevant)”, so the provision reads as follows:

“(v) the adequacy of the information given by the licensee and the product issuer (if relevant); and”

(b) Paragraph 761GA(e) of the Act should be amended so that the words “product or advice” are replaced with “product or service”, so the provision reads as follows:

“*(e) the licensee gives the client before, or at the time when, the product or service is provided a written statement of the licensee's reasons for being satisfied as to those matters; and*”

(c) Subparagraph 761GA(f)(i) of the Act should be amended to include the words “(if relevant)”, to the provision reads as follows:

“(i) the licensee has not given the client a Product Disclosure Statement (if relevant); and”

8.8 Alignment with Chapter 6D

We consider any change made with respect to the sophisticated investor assessment test as contained in Chapter 7 of the Act should also be made in relation to the equivalent test in Chapter 6D of the Act.

9. **Consent requirements**

9.1 Introduction

We are supportive of the introduction of consent requirements in order for a person to be treated as a wholesale client. We consider a uniform consent requirement should be implemented for all wholesale client tests (refer to section 3 of this submission), except the sophisticated investor assessment test, as that test inherently includes a consent process, particularly if the revised sophisticated assessment test contemplated by us in section 8.4 were to be implemented. The

concept of a "consent requirement" exists in some form in both New Zealand and Singapore.

9.2 New Zealand

In New Zealand, the closest thing to a "consent requirement"[68] is the concept of a "safe harbour certificate". The purpose of the "safe harbour certificate" provision is to provide certainty to an offeror (or other relevant person) that a person is a wholesale investor of a certain kind.[69] The provision provides a person must be treated as being a wholesale investor if, among other things, the person certifies in writing that they are a wholesale investor of the relevant kind and understand the consequences of certifying themself to be a wholesale investor. A safe harbour certificate is also required to include a warning statement at the front and in a prominent position, which must be in the following form:[70]

> *"**Warning***
>
> *New Zealand law normally requires people who offer financial products to give information to investors before they invest. This information is designed to help investors make an informed decision.*
>
> *If you are a wholesale investor, the usual rules do not apply to offers of financial products made to you. As a result, you may not receive a complete and balanced set of information. You will also have fewer other legal protections for these investments.*
>
> *Ask questions, read all documents carefully, and seek independent financial advice before committing yourself.*
>
> ***Offence***
>
> *It is an offence to give a certificate knowing that it is false or misleading in a material particular. The offence has a penalty of a fine not exceeding $50,000."*

It is noted product issuers in Australia already have the benefit of certainty as to a person meeting the individual wealth test by virtue of the requirement of a certificate being given by a qualified accountant so a "safe harbour" provision is not strictly required, at least in relation to the individual wealth test.

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[68] Aside from the inherent consent involved in the equivalent of the sophisticated investor assessment test, as outlined in section 8.4 of this submission)

[69] See clause 44 of Schedule 8 of the *Financial Markets Conduct Regulations 2014* (New Zealand), the relevant kinds to this submission being the "investment activity" test or the "large" test contained clauses 38 and 39, respectively.

[70] See clause 48 of Schedule 8 of the *Financial Markets Conduct Regulations 2014* (New Zealand).

9.3 Singapore

In Singapore, a person may only be treated as an accredited investor for the purposes of certain provisions if that person had opted to be treated as an accredited investor. [71] In order for a person to "opt-in" to be treated as an accredited investor, the person that wishes to treat them as an accredited investor must provide to them a statement that they have assessed them to be an accredited investor, that they may consent to being treated as an accredited investor (and may withdraw that consent at any time), and provide the following prescribed general warning:

> "*Accredited investors are assumed to be better informed, and better able to access resources to protect their own interests, and therefore require less regulatory protection. Investors who agree to be treated as accredited investors therefore forgo the benefit of certain regulatory safeguards. For example, issuers of securities are exempted from issuing a full prospectus registered with the Monetary Authority of Singapore in respect of offers that are made only to accredited investors, and intermediaries are exempted from a number of business conduct requirements when dealing with accredited investors. Investors should consult a professional adviser if they do not understand any consequence of being treated as an accredited investor."*

The provider must also provide a clear explanation in plain language of the effect of being treated as an accredited investor and in sufficient detail as to enable them to make an informed decision whether to opt to be treated as an accredited investor. Having been provided the above, the person then needs to give the relevant person a statement in writing the effect of which is that the person to be treated as an accredited investor knows and understands the consequences of consenting to being treated as an accredited investor, and consents to being treated as an accredited investor (and they know they can withdraw this consent at any time).

With respect to the above, we do not consider it is appropriate for a client to "opt-out" of being treated as a wholesale client, at least insofar as a product issuer is concerned. Otherwise, wholesale fund managers may find themselves routinely in breach of the financial services laws by providing ongoing financial services (such as advice or a custodial or depository service) not covered by their AFS licence.[72] A persons status as a wholesale client should be preserved for the duration they hold a product.[73]

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[71] Refer to regulation 3 of the *Securities and Futures (Classes of Investors) Regulations 2018* (Singapore).

[72] We note wholesale fund managers are generally not authorised to provide any financial services to retail clients.

[73] Refer to our submission regarding the effect of wholesale client status in section 10.

9.4 Design and implementation

In terms of the implementation of a "consent requirement" in Australia, we consider the following "obligations" should be imposed on a person seeking to treat a person as a wholesale client, in order for that person to be treated as a wholesale client:

(a) There should be an obligation for an AFS licensee to obtain the consent of the client to their treatment as a wholesale client.

(b) There should be an obligation for an AFS licensee (or product issuer) to provide a prescribed "warning"[74] to the subject client, with the warning specifying the protections they would be losing by being treated as a wholesale client that Treasury considers material to a client (such as there being no requirement to provide a Product Disclosure Statement).

The consent requirement should be designed such that it can be readily implemented by fund managers without material disruption to their existing processes and procedures. In particular, we consider the obligation to obtain consent should be able to be satisfied as part of the applicant onboarding process, whether by paper application form or online application. In practice, we expect this to involve the inclusion of a statement in application forms that provides by applying to invest, the relevant person consent to being treated as a wholesale client. The warning should also be in a form that can readily be included in the application form (whether online or on paper).

10. Grandfathering

Any revision of the wholesale client tests has the potential to cause commercial disruption and lead to the incurrence of substantial regulatory and compliance costs. A revision would also disrupt investor expectations as to their status as a wholesale client and the investments they are eligible to make.

Treasury should give careful consideration to how any transitional periods would apply should the wholesale client tests change. For example, it would need to be clear that any changes to the thresholds would only be prospective, and would not affect investors who might previously have invested in a fund as wholesale clients. Likewise, a clear regime would need to be established for those investors who had invested in a fund as a wholesale client so that they may continue to be treated as a wholesale client with respect to their investment, so they may increase their holding in such fund, such as pursuant to a distribution reinvestment plan or through participation in a rights offer, and in doing so continue to be treated as a wholesale client.

[74] Similar to the position in New Zealand and Singapore, and similar to the prescribed consumer advisory warning contained in *ASIC Corporations (Disclosure of Fees and Costs) Instrument 2019/1070*.

We consider "grandfathering" could (at least in part) effectively be implemented by revising regulation 7.1.27 of the Regulations to apply to all wholesale client tests, and not just the product value test, with retrospective application. Subregulation 7.1.27(1) of the Regulations currently provides as follows:

> "*For subsection 761G(10) of the Act if, at any time, the holder of a financial product is a wholesale client in relation to the product because of paragraph 761G(7)(a) of the Act:*
>
> *(a) the holder is taken, on and after that time, to be a wholesale client in relation to the product as between the holder and:*
>
> *(i) the issuer of the product; or*
>
> *(ii) if a related body corporate of the issuer of the product provides a custodial or depository service to the holder of the product in relation to the product--the related body corporate;*
>
> *for the period during which the holder holds the product; and*
>
> *(b) paragraph (a) applies whether or not the holder would, but for that paragraph, have otherwise been or become a retail client in relation to that product at some time."*

The above regulation only applies in relation to people who are wholesale clients because they met the product value test (i.e., "because of paragraph 761GA(7)(a) of the Act").[75] We consider the above regulation should be amended so that it applies to a person who is a wholesale client by any means. Ideally, the regulation would also be amended so it captures increased holdings of the same type of financial product by such a person, such that a person who acquired an interest in a scheme as a wholesale client may increase their holding and in doing so continue to be treated as a wholesale client, notwithstanding they may have ceased to qualify as a retail client pursuant to the individual wealth test. We consider this to be logical from a policy perspective, as it cannot be said that a person who was once "sophisticated" insofar as a particular product is concerned subsequently becomes "unsophisticated" with respect to that same product.

It should also be considered whether the regulation also needs to be amended so that it clearly applies in relation to any financial services provided to the holder by the product issuer that are incidental to their holding of the product, such as the provision of financial product advice or the provision of a custodial or depository service.

We consider the above change should be made even if it is not adopted as a means to address "grandfathering" any wholesale client test changes. It should be a change made to the financial services laws. There is currently the opportunity for considerable issues to be caused for wholesale fund managers

[75] Being the test contained in paragraph 761G(7)(a).

where investment is accepted from a person because they satisfy the individual wealth test. It could be, for example, that a person that once met the individual wealth test because they had the requisite gross income, no longer meets that test in the future given they, for example, changed from being a full-time employee to a part time employee and therefore cannot supply an appropriate accountant certificate. If this were to be the case, then wholesale fund managers would generally be in breach of their AFS licence, as ongoing financial services (such as financial product advice or a custodial or depository services) would be provided to them as a retail client, which is not often covered by an AFS licence held by a wholesale fund manager.

11. Ongoing revision of the thresholds

Having regard to the fact the financial thresholds for the product value test and the individual wealth test have remain unchanged since the enactment of the FSRA, we consider it is appropriate for a mechanism to be included in the law that provides for the financial thresholds to be regularly reviewed. We note it was always the legislative intent that the financial thresholds be subject to review, with the financial thresholds being specified in the regulations to provide greater flexibility to update the relevant amounts in the future. [76] Notwithstanding this flexibility, the thresholds have remain unchanged.

In terms of the ongoing revision of the thresholds, there are a number of different approaches that can be taken. For example, it could be determined the thresholds be recalibrated on a formulaic indexing basis every five years (or such other period considered appropriate), such as to account for inflation. We do not consider this to be a desirable mechanism.

Rather than including a legislating a formulaic mechanism that automatically revises the financial thresholds to accord with, for example, inflation, we consider a review mechanism should be included that empowers the Australian Securities and Investments Commission (ASIC) to review the thresholds every five years, with the revisions to be effected by ASIC instrument.

We note in the United States of America there is a mechanism whereby the Securities and Exchange Commission (SEC) may review the definition of “accredited investor” no more frequently than once every four years. Subsection 413(b)(2) of Title IV of the *Dodd-Frank Act* provides as follows:

> *“(A) SUBSEQUENT REVIEWS.—Not earlier than 4 years after the date of enactment of this Act, and not less frequently than every 4 years thereafter, the Commission shall undertake a review of the definition, in its entirety, of the term “accredited investor”, as defined in section 230.215 of title 17, Code of Federal Regulations, or any successor thereto, as such term applies to natural persons, to determine whether the requirements of the definition should be adjusted or modified for the*

[76] See paragraph 3.11 of the second supplementary explanatory memorandum to the FSRB.

protection of investors, in the public interest, and in light of the economy.

(B) *ADJUSTMENT OR MODIFICATION.—Upon completion of the review under subparagraph (A), the Commission may, by notice and comment rulemaking, make such adjustments to the definition of the term "accredited investor", as defined in section 230.215 of title 17, Code of Federal Regulations, or any successor thereto, as such term applies to natural persons, as the Commission may deem appropriate for the protection of investors, in the public interest, and in light of the economy."*

We consider an equivalent review power could be given to ASIC with appropriate restrictions on the extent and nature of the review. For example, in exercising such power, ASIC should be required to consider similar factors as those required to be considered by the SEC in the United States of America, including the state of the economy (both the current state of the economy and changes in the economy since the previous review). Before exercising this power, ASIC should be required to call for submissions on the proposed changes and have regard to those submissions in exercising its power.

We also consider that upon exercise of any review power, the revised thresholds or tests should only apply to new investments, and not in relation to existing holdings (or re-investments pursuant to a distribution reinvestment plan or with respect to the increasing of any existing holdings). We consider our proposed submission as to the revision of subregulation 7.1.27(1) of the Regulations (refer to section 10 of this submission) would (at least in part) resolve this issue.

12. Further submission

We would like to take this opportunity to raise some other issues with Treasury with respect to the wholesale client tests. Regulation 7.1.27 of the Regulations contains provisions relevant to the effect of wholesale client status. Subregulation 7.1.27(2) provides as follows:

"For subsection 761G(10) of the Act, if:

(a) *a person is a wholesale client in relation to the product because of paragraph 761G(7)(a) or paragraph (1)(a); and*

(b) *another person becomes a holder of the financial product; and*

(c) *the issuer did not know, and could not reasonably be expected to have known:*

  (i) *whether another person had become the holder of the financial product; or*

  (ii) *whether any subsequent holder of the financial product was a retail client or a wholesale client;*

> *the issuer is taken not to be guilty of any offence, or to be liable under civil penalty or civil liability provisions under the Act, merely because the issuer has not treated any subsequent holder of that financial product as a retail client."*

We consider the above should be amended in a similar way to that proposed in relation to subregulation 7.1.27(1) (refer to section 10 of this submission). That is, paragraph (a) should be amended to refer to wholesale clients generally, and not just "because of paragraph 761G(7)(a)", which only covers the product value test.

We also consider the above should be amended to provide the subsequent holder is taken to be a wholesale client, rather than just providing the issuer is not guilty of an office or otherwise liable under the Act. Otherwise, the operation of the provision may create issues in the context of an AFS licensee that is only authorised to provide financial services to wholesale clients, particularly in the context of the current reportable situations regime.

We also consider the above should be amended to capture a scenario where there has been (or is to be) transmission of the product at law (such as pursuant to the terms of a Will) from one person to another. Currently, product issuers often find themselves in a tricky situation whereby a person who invested in their fund as a wholesale client subsequently passes away and whose wishes included the transmission of interests in wholesale funds to their heirs, who may be retail clients. In this scenario, a product issuer may be required to exercise its discretion to decline the transfer so as to avoid it breaching the financial services laws, leaving the interest tied up in the estate (or at least held on trust for the intended heir).[77] Otherwise, the product issuer can approve the transfer and pontentially find themselves in breach of the financial services laws, as the holder is now a retail client (and incidental services, such as advice and custodial or depository services, are provided to them on an ongoing basis). We would like to see regulation 7.1.27 of the Regulations be amended to provide such a subsequent holder is taken to be a wholesale client, as between them and the product issuer, in relation to the holding of the product and the provision of incidental financial services.

13. Contact

Should Treasury have any comments in relation to our submissions in relation to the questions covered by "Chapter 1—Wholesale client thresholds" of the consultation paper, or should Treasury like to discuss any particular points raised, please contact Elliott Stumm.

[77] We note wholesale fund managers are generally not authorised to provide any financial services to retail clients.

Chapter 2—Suitability of scheme investments

14. Questions addressed

This part contains submissions in response to the following questions:

(a) Question 5—*Should conditions be imposed on certain scheme arrangements when offered to retail clients? If so, what conditions and why?*

(b) Question 6—*Are any changes warranted to the procedure for scheme registration? If so, what changes and why?*

(c) Question 7—*What grounds, if any, should ASIC be permitted to refuse to register a scheme?*

15. Question 5—Conditions on certain scheme arrangements

We do not consider it necessary or appropriate for conditions to be imposed on certain scheme arrangements when offered to retail clients. The consultation paper references other jurisdictions where conditions are imposed to seek to ensure more diversified and liquid options are offered to retail clients. However, diversification and liquidity alone do not equate to the risk level of a fund. For example, a single asset property fund that is fully leased with a weighted average lease expiry and debt finance that matches the investment term of the fund would be of equal or even less risk than a diversified listed equities fund.

We are also concerned about the time it would take for conditions to be assessed as part of the scheme registration process.

Finally, there are existing regulations, including the design and distribution obligations and the product intervention power that are aimed to ensure that products are only marketed to those investors to which the product would be appropriate.

16. Question 6—Procedure for scheme registration

Whilst we do not consider there is any need for large scale amendments to the procedure for scheme registration, we are a member of the working group that prepared the submission for the FSC and support Recommendation 4 in response to this question in the FSC submission.

17. Question 7—Refusal to register a scheme

We do not consider ASIC should have any additional grounds (beyond those in section 601EB of the Act) to refuse to register a scheme.

Chapter 3—Scheme governance and the role of the responsible entity

18. Questions addressed

This part contains submissions in response to the following questions:

(a) Question 8—*Are any changes required to the obligations of responsible entities to enhance scheme governance and compliance? If so, what changes and why?*

(b) Question 9—*Should ASIC be able to direct a responsible entity to amend a scheme's constitution to meet the minimum content requirements, similar to the CCIV regime?*

(c) Question 12—*Should responsible entities be required to have a majority of external board members, similar to the CCIV regime?*

We have not included responses to the following questions in this submission as we do not consider any changes should be made:

(a) Question 10—*Are changes required to the compliance plan provisions to ensure compliance plans are more tailored to individual schemes? If so, what changes and why?*

(b) Question 11—*Should auditors be legislatively required to meet minimum qualitative standards when conducting compliance plan audits? If so, what should these standards be and why?*

19. Question 8—Obligations of responsible entities

We do not consider any changes are required to the obligations of responsible entities to enhance scheme governance and compliance. We note in addition to those obligations imposed by the Act, responsible entities are subject to duties at law as trustees.

20. Question 9—Power to direct a responsible entity to amend a constitution

While we are generally supportive of parity of regulation between managed investments schemes and CCIVs, we do not consider it appropriate for ASIC to be able to direct a responsible entity to amend a scheme's constitution to meet the minimum content requirements. Any perceived deficiency in this regard should be addressed as part of the scheme registration process.

Treasury should also be mindful of potential issues that may arise from the exercise of such powers in the context of the laws relating to the resettlement of trusts.

21. Question 12—Requirement to have an external board

We note the corporate director of a retail CCIV is only required to have “at least half” of its directors as external directors, not “a majority of external board members”.[78] While we are generally supportive of parity of regulation between managed investments schemes and CCIVs, we do not consider it appropriate for responsible entities to be compelled to have at least half of its board of directors be external directors. In fact, we would prefer to see the CCIV framework revised to afford a retail corporate director the choice as to whether they have a compliance committee or at least half their board be comprised on external directors. However, we appreciate a review of the CCIV framework is beyond the scope of the review being conducted by Treasury.

We consider that the expertise and focus of a compliance committee is beneficial to responsible entities and provides the required check on the role and responsibilities of the responsible entity in connection with the fund.

We support the recommendation and reasoning supplied in the FSC submission on this question.

[78] See section 1224G of the Act.

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Chapter 4—Right to replace the responsible entity

22. Questions addressed

This part contains submissions in response to the following questions:

(a) Question 13—*Are any changes required to the voting requirements or meeting provisions that allow members to replace the responsible entity of a listed scheme? If so, what changes and why?*

(b) Question 14—*Are any changes required to the voting requirements or meeting provisions that allow members to replace the responsible entity of an unlisted scheme? If so, what changes and why?*

(c) Question 15—*In what circumstances should an existing responsible entity be required to assist a prospective responsible entity conduct due diligence? What might this assistance look like?*

(d) Question 16—*Should there be restrictions on agreements that the responsible entity enters into or clauses in scheme constitutions that disincentivise scheme members from replacing a responsible entity? If so, what restrictions may be appropriate?*

23. Questions 13 and 14—Voting requirements

Currently, if members of an unlisted registered scheme want to replace the responsible entity, they need to consider and vote on—

(a) an extraordinary resolution that the current responsible entity be removed (unless the responsible entity is retiring), and

(b) an extraordinary resolution choosing a new responsible entity.[79]

With respect to a listed registered scheme, the same resolutions need to be passed, but only an ordinary resolution is required rather than an extraordinary resolution.[80]

The above can be contrasted with the rules regarding the replacement of a corporate director of a CCIV. In order to replace the corporate director of a CCIV, equivalent resolutions to the above need to be passed, but only a special resolution is required.[81] This applies to both listed and unlisted CCIVs, and both retail and wholesale CCIVs.

[79] See sections 601FL and 601FM of the Act.

[80] See sections 601FM and 601FL. Refer also to Class Order [CO 13/519] *Changing the responsible entity* and *MTM Funds Management v Cavalane Holdings Pty Ltd* [2000] NSWSC 922.

[81] See sections 1224T and 1224U of the Act.

While we are generally supportive of the parity of regulation of CCIVs and registered managed investment schemes (as far as practicable),[82] we do not consider it necessary to amend the voting requirements for the replacement of a responsible entity. In fact, we would prefer to see the CCIV framework revised to make the provisions regarding the replacement of the corporate director align with the current framework as it applies to responsible entities. However, we appreciate a review of the CCIV framework is beyond the scope of the review being conducted by Treasury.

Whilst not strictly in connection with the meeting provisions or voting requirements for removal of a responsible entity, we would like to take to the opportunity to submit that amendments are required to section 601FN of the Act to extend the circumstance where ASIC or a member of a registered scheme can apply to the court for appointment of a temporary responsible entity.

Currently, section 601FN of the Act only allows an application to the court for appointment of a temporary responsible entity to be made where the responsible entity is not a public company or ceases to hold an AFS licence. This section should be amended to include the following circumstances as grounds for an application to the court:

(a) Where the responsible entity is placed into administration or liquidation. This will allow ASIC or members of a scheme to take swift action where the responsible entity is in administration or liquidation but still holds an AFS licence.

(b) Where ASIC or a member reasonably believes that the appointment is necessary to protect scheme property or the interest of members of the scheme. Whilst the power to apply to the court where these circumstances have arisen is currently included in regulation 5C.2.02 of the Regulations, there is no corresponding power under the Regulations for the court to appoint a temporary responsible entity if an application has been made, like there is in section 601FP in respect of applications under sections 601FL or 601FN of the Act.

As an alternative to paragraph (b) above, the Regulations could be amended to provide the court with the relevant power.

24. Question 15—Assistance requirement

We consider that any regulatory requirement for an existing responsible entity to assist a prospective replacement responsible entity conduct due diligence would need to be carefully considered.

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[82] We note the explanatory memorandum to the *Corporate Collective Investment Vehicle Framework and Other Measures Bill 2021* (Cth) noted “regulatory parity is maintained (to the extent possible) between the existing MIS framework and the CCIV framework” (paragraph 1.24), however as is evident from the questions posed by Treasury in this consultation paper, that was not as much the case as it could have been.

Whilst the lack of ability to conduct due diligence where the responsible entity is being replaced in hostile circumstances may disincentivise prospective responsible entities from wanting to take on the role, there are circumstances where cooperation would not be in the best interest of investors or would be overly prejudicial to the existing responsible entity. These circumstances include the following:

(a) Given that a vote to remove the responsible entity can be called by members holding 5 percent of the interests in a scheme, a competitor of the responsible entity may call the meeting for its own self-interest (for example, to get hold of records of the existing responsible entity) rather than doing so in the best interest of members. As such, any right to cooperate must only arise where the prospective responsible entity (and members calling for the change of responsible entity) are acting honestly and in good faith.

(b) Due diligence would generally involve a significant time and cost expenditure by the existing responsible entity. As this is a cost that would be incurred in the proper performance of duties of the responsible entity it could be recovered from the assets of the fund. Where the acts of the prospective responsible entity cause excessive expenses to be incurred, these should be paid by the prospective responsible entity.

(c) As part of the process the prospective responsible entity may acquire confidential information of the existing responsible entity. This information should be protected by a mandatory non-disclosure arrangement with statutory force. The disclosure obligation should also be limited to only that information which an incoming responsible entity would need to know to assess the risks of taking on the responsible entity role.

25. Question 16—Restrictions on disincentivising arrangements

We do not consider there needs to be any additional provisions regulating arrangements that may disincentivise scheme members from replacing a responsible entity. We consider the current provisions of the Act (and the fiduciary duties imposed on the responsible entity as a trustee at law) sufficiently protect members in this regard.

We consider the disclosure provisions of the Act provide adequate protection to investors by way of their being informed of any ‘disincentivising’ arrangements that may be in place with respect to the scheme, before making a decision as to whether or not to invest.

Further, in addition to fiduciary duties at law, a responsible entity is subject to a number of duties under the Act.[83] Among other duties, a responsible entity is required to act in the best interests of the members and, if there is a conflict between the members' interests and its own interests, give priority to the members' interests.[84] We consider this provides investors with sufficient protection against disincentivising arrangements being entered

[83] Section 601FC of the Act.

[84] Paragraph 601FC(1)(c) of the Act.

into as part of the operation of a scheme where doing so would not be in the best interests of members.

We also note if the responsible entity is to have any rights to be paid fees out of scheme property, those rights must be specified in the scheme's constitution, and must be available only in relation to the proper performance of its duties.[85]

As a final note, we are generally supportive of parity of regulation between managed investments schemes and CCIVs. Any revisions to the managed investment scheme framework should not result in the addition of provisions that regulate disincentivising arrangements above and beyond those that apply in relation to CCIVs. In this context, the duties imposed on corporate directors,[86] the requirement for rights for fees to be paid out of the assets to be specified in the constitution and only be available in relation to the proper performance of those duties[87] (including any termination payments),[88] and the provisions governing related party transactions,[89] are the main forms of “protection” of investors with respect to disincentivising or entrenchment arrangements, which is consistent with the current position for registered schemes.

[85] Subsection 601GA(2) of the Act.

[86] See section 1224C and 1224D of the Act.

[87] See section 1224N of the Act.

[88] See subdivision D of Division 2 of Part 8B.3 of the Act, and in particular section 1224ZC of the Act.

[89] See Division 5 of Part 8B.3 of the Act.

Chapter 5—Right to withdraw from a scheme

26. Questions addressed

This part contains submissions in response to the following questions:

(a) Question 17—*Is the definition of liquid assets appropriate? If not, how should liquid assets be defined?*

(b) Question 18—*Are any changes required to the procedure for withdrawal from a scheme? If so, what changes and why?*

(c) Question 19—*Is there a potential mismatch between member expectations of being able to withdraw from a scheme and their actual rights to withdraw? If so, how might this be addressed?*

27. Question 17—Definition of liquid assets

The current definition of liquid assets in subsections 601KA(5) and (6) of the Act provides for specific types of assets that will generally be liquid and then the ability for the responsible entity to classify other types of assets as liquid where the responsible entity reasonably expects that it can be realised for its market value within the period specified in the constitution for satisfying withdrawal requests while the scheme is liquid.

We consider this definition is appropriate and should not be amended.

The existing definition provides certainty, in that the test for whether an asset is liquid is quantitative, and flexible in that it allows the responsible entity to provide for a longer period in which to realise assets under the constitution.

The consultation paper refers to concerns raised with the definition in the 2014 CAMAC discussion paper. It was this paper that raised the suggestion that liquidity should be limited to that assets that can reasonably be expected to be realised for market value within seven business days. The CAMAC discussion paper consider that this revised definition would address issues surrounding uncertainty, independent verification and clarity. We do not agree with this proposal and consider that such a limited definition would have a detrimental effect on investors' access to liquidity within schemes.

In setting the time within which the asset must be realised in the constitution, the responsible entity must have regard to its duties in section 601FC of the Act. These duties include the duty to act in the best interest of members,[90] exercise a degree of care and diligence that a reasonable person would exercise if they were in the responsible entity's position,[91] and to ensure that the scheme's constitution complies with the

[90] Paragraph 601FC(1)(c) of the Act.

[91] Paragraph 601FC(1)(b) of the Act.

requirements of sections 601GA and 601GB of the Act.[92] Subsection 601GA(4) of the Act requires the responsible entity to ensure that rights to withdraw and procedures for making and dealing with withdrawal request are specified in the constitution and that they are fair to all members.

Furthermore, as part of its risk management procedures, ASIC requires responsible entities to have liquidity risk management processes to ensure there are adequate financial resources to meet the financial obligations and needs of the fund operator and the funds operated.[93]

Therefore, the responsible entity's seemingly broad power provided by subsection 601KA(6) has to be considered in light of the responsible entity duties and other regulatory requirements.

The current test enables a responsible entity to develop a product which is liquid in order to meet the liquidity requirements of investors. This is done through managing redemption requests in accordance with available liquidity without having to make a withdrawal offer.

In our experience, responsible entities are reluctant to make withdrawal offers pursuant to the Act. This is for a range of factors, including the following:

(a) The formal process required to be undertaken, which increases the time and cost of providing liquidity to investors.

(b) The inability to scale the amount of liquidity available to satisfy the demand.

(c) It may encourage some investors to withdraw who were not considering withdrawal prior to receipt of the withdrawal offer.

(d) The message issuing a withdrawal offer may send to the market.

As such, if a more stringent test for liquidity is introduced causing a larger number of schemes to be illiquid, it is likely that the level of liquidity offered in those funds will be significantly reduced. This will have a detrimental effect on investors.

28. Question 18—Withdrawal procedures

Provided there is no change to the definition of liquid assets, then changes to the procedures for withdrawal form a scheme are not required.

Responsible entities have worked to develop processes and procedures whereby liquidity and investor's withdrawal rights are managed within the current system. The results from ASIC's recent targeted surveillance of responsible entities and registered schemes in

[92] Section 601FC(1)(g) of the Act.

[93] ASIC Regulatory Guide 259.

respect of liquidity risk management processes[94] demonstrated this to generally be the case.

29. Question 19—Mismatch between member expectations and rights

Where a mismatch between member expectations and rights arises, it is not due to the provisions of Part 5C.6 of the Act but rather a lack of education of investors or a lack of effective disclosure.

As discussed in section 27, the current definition of liquid assets and balance of the withdrawal provisions allow responsible entities to provide liquidity to investors in products they would not be able to do so if a more limited test of liquidity was introduced. This would have a detrimental effect on investors, more so than a mismatch of expectations.

There are current provisions within the regulatory framework that can be used to combat any investor misunderstanding, in particular disclosure to investors and the design and distribution obligations, including the following:

(a) The product disclosure statement is required to include information about liquidity of the scheme and withdrawal rights of members. As withdrawal rights is a significant benefit for investors, the disclosure must outline the circumstances in which and times at which the benefit will or may be provided and the way in which it will or may be provided and also the risks that they will not be provided at all times.[95]

(b) For property schemes and mortgage schemes, ASIC regulatory guidance requires enhanced disclosures on certain aspects, including against principles and benchmarks relating to withdrawal arrangements.[96] Both guides require disclosure in relation to the circumstances in which investors can withdraw, the maximum withdrawal period allowed under the constitution for the scheme (with a requirement that this disclosure should be at least as prominent as any shorter withdrawal period promoted to investors), and any significant risk factors or limitations that may affect the ability of investors to withdraw from the scheme (including risk factors that may affect the ability of the responsible entity to meet a promoted withdrawal period). This standard of disclosure should be required for all types of schemes and should also be included in the product disclosure statement in a way that it makes it easier for retail investors to comprehend.

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[94] See ASIC MR 20-218, *ASIC tells fund managers to be 'true-to-label'* (22 September 2020) and ASIC MR 21-091 *ASIC review finds retail managed funds responded well to COVID-19 challenges in 2020* (30 April 2021).

[95] Subsections 1013D(1)(b) and (c) of the Act.

[96] ASIC Regulatory Guide 45 and ASIC Regulatory Guide 46.

(c) Prohibitions on misleading and deceptive conduct in the Act would also prevent a responsible entity from disclosing that a scheme is liquid without also disclosing that there are conditions on which the scheme is liquid (for example, the fund is only liquid because the responsible entity has 365 days within which to realise the assets).

(d) Liquidity and withdrawal rights is a key consideration for responsible entities and distributors in discharging their obligations under the design and distribution obligations. Recent stop orders and ASIC reports on target market determinations have provided further guidance on how liquidity should be treated. This should assist with ensuring that investors acquire products that fit their liquidity needs.

On balance the potential detriment to investors who misunderstands that a liquid scheme does not necessarily mean the responsible entity will be able to realise all assets in a short timeframe is much less than the potential detriment to investors were a more inflexible definition of liquidity to be introduced.

30. Contact

Should Treasury have any comments in relation to our submissions in relation to the questions covered by “Chapter 5—Right to withdraw from a scheme” of the consultation paper, or should Treasury like to discuss any particular points raised, please contact Emma Donaghue.

Chapter 6—Winding up insolvent schemes

31. Questions and responses

We confirm that we agree with and support the submissions made by the FSC in relation to the following questions:

(a) Question 20—*Are any changes required to the winding up provisions for registered schemes? If so, what changes and why?*

(b) Question 21—*Would a tailored insolvency regime for schemes improve outcomes for scheme operators, scheme members and creditors? Are there certain aspects of the existing company and CCIV insolvency regimes that should be adopted?*

(c) Question 22—*Should statutory limited liability be introduced to protect personal assets of scheme members in certain circumstances? If not, why not?*

Chapter 7—Commonwealth and state regulation of real property investments

32. Questions addressed

This part contains submissions in response to Question 23—*Do issues arise for investors because of the dual jurisdictional responsibility when regulating schemes with real property? If so, how could they be addressed?*

33. Response

We do not consider there to be any issues. A number of our clients operate property schemes (and hold real estate licences in addition to AFS licences) and we have not received any feedback as to issues associated with dual jurisdictional regulation.

Chapter 8—Regulatory cost savings

34. Questions addressed

This part contains submissions in response to Question 24—*What opportunities are there to modernise and streamline the regulatory framework for managed investment schemes to reduce regulatory burdens without detracting from outcomes for investors?*

35. FSC submission

With reference to the table of issues provided in the FSC submission in response to this question, we would welcome regulation in respect of the following:

(a) Removing the requirement to report trivial breaches of the compliance plan.

(b) Streamline regulatory filings with ASIC.

(c) Transition wet ink signature requirements to electronic signatures.

(d) Client money rules (section 1017E) for schemes that process applications monthly.

36. Written resolutions

One change to the meeting provisions we would like to see is the amendment of those provisions to accommodate the passing of member resolutions in writing. Doing so would alleviate the need for considerable costs to be incurred (paid out of scheme property) and reduce the inconvenience associated with calling and holding member meetings, whether by videoconference or in person.

37. Holding application money

Section 1017E of the Act provides that if a product provider receives application money from an investor and does not immediately issue that investor with the product, then the provider must hold the application money on trust. Subsection 1017E(4) of the Act then states (in summary) that a product provider must either return application money to an applicant or issue the financial product to it either—

(a) before the end of one month starting on the day on which the money was received, or

(b) if it is not reasonably practicable to do so before the end of that month—by the end of such longer period as is reasonable in the circumstances.

We would like to see the provisions regulating the amount of time a product issuer can hold application money to be amended so that there is clear alignment with sections 1016C and 1016E of the Act.

Section 1016C of the Act effectively provides (in summary) that if a product disclosure statement states a financial product will not be issued unless applications for a minimum number are received or a minimum amount is raised, then the responsible person is prohibited from issuing the product unless the condition has been satisfied. If the minimum subscription target is not met within four months, then subsection 1016E(2) of the Act requires the responsible manager to (among other options) repay the money received from applicants.

We would like to see section 1017E of the Act be amended to allow a responsible person to hold application money for so long as is permissible under sections 1016C and 1016E.