

IMPACT OF REVISED WHOLESALE INVESTOR THRESHOLDS: A BRISBANE ANGELS PERSPECTIVE.



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About

Brisbane Angels was set up in 2006 to support high growth ventures. It is one of the largest and most active business angel networks in Australia, connecting high potential companies with our investor members, to collaborate with exceptional founders, and collectively forge revolutionary companies. We have invested \$35 million across more than one hundred early-stage growth companies in that time with more than \$3 million invested over the past year.

This paper was authored by Mr. Brian Cooke, a long-term member and former director of Brisbane Angels. It was reviewed and endorsed by the board of Brisbane Angels Group Limited.

Introduction

In August 2023, the Australian Treasury started a significant review of the country's financial regulatory framework, specifically targeting the regulations governing managed investment schemes (MIS). This review, captured in the consultation paper "**Review of the Regulatory Framework for Managed Investment Schemes**" goes beyond mere regulatory adjustments.

It delves into the broader implications for market accessibility, investor autonomy, and economic stability.

Central to this review is the reassessment of the criteria defining sophisticated or wholesale investors. These criteria, which have remained unchanged since 2001, classify investors based on their financial assets and income levels, thus deciding their eligibility for certain investment opportunities that are inaccessible to the general public.

Under the current regulations, an individual qualifies as a sophisticated investor if they have:

- a) a net worth of \$2.5 million, including their primary residence, or
- b) a gross income of at least \$250,000 for two consecutive years, as verified by an accountant.

This classification enables them to partake in complex and potentially high-reward investment opportunities, such as private equity, venture capital, seed funding for start-ups, and non-public real estate investments. However, it also involves relinquishing certain consumer protections, like access to conflict-free financial advice and recourse through government dispute resolution services.

The proportion of Australians meeting these criteria has increased significantly. In 2002, only about 1.9% of the population qualified as sophisticated investors, but by 2021, this figure had risen to over 16%, according to research by Ben Phillips, an associate professor at the Australian National University.

This shift in demographics, combined with the evolving nature of financial markets, needs a balance between protecting investors and fostering a vibrant, dynamic investment environment. Any shifts in this balance will have far-reaching consequences, not just for individual investors but for the broader economic fabric of the nation.

By delving into these proposed changes, and evaluating their potential impact through various lenses, in particular the perspective of Brisbane Angels, this document looks to offer a balanced analysis on the subject.

Proposed Changes

The Australian Securities and Investments Commission (ASIC) has put forth a proposal to amend the criteria for an individual to be classified as a sophisticated or wholesale investor. The primary change suggested involves a significant increase in the financial thresholds required for an individual to qualify as a sophisticated investor. The proposal recommends:

- Raising the minimum net assets requirement from the existing \$2.5 million to \$5 million.
- Similarly, the gross income threshold to increase from \$250,000 to \$500,000 per annum.

ASIC's view is that these adjustments reflect an acknowledgment of inflation and economic changes since the thresholds were last set. One has to ask ASIC's logic extends to the thresholds imposed on a range of other government regulations including payroll tax and income tax.

Supporters argue that higher thresholds are a prudent step towards ensuring investor safety, especially in an increasingly complex financial world. Critics, on the other hand, contend that these changes could unduly restrict market access, potentially stifling the flow of capital to innovative ventures and altering the investor landscape.

As we examine various perspectives on these changes, including those of key stakeholders like Brisbane Angels, it becomes clear that the implications of such a regulatory shift are far-reaching, affecting not just the criteria of who gets to invest but also the very dynamics of investment in Australia's financial markets. We understand and respect ASIC's intention to enhance investor protection; however, we believe that the current system effectively balances this protection with market accessibility, a balance crucial for fostering innovation and growth.

International benchmarks.

As Australia contemplates revisions to its sophisticated investor thresholds, a global comparison is insightful. This comparison not only offers a global viewpoint but also clarifies the implications of these changes on our international standing and investment.

Wholesale / Sophisticated Investor Test

Shown in AUD equivalent as at 22nd January 2024.

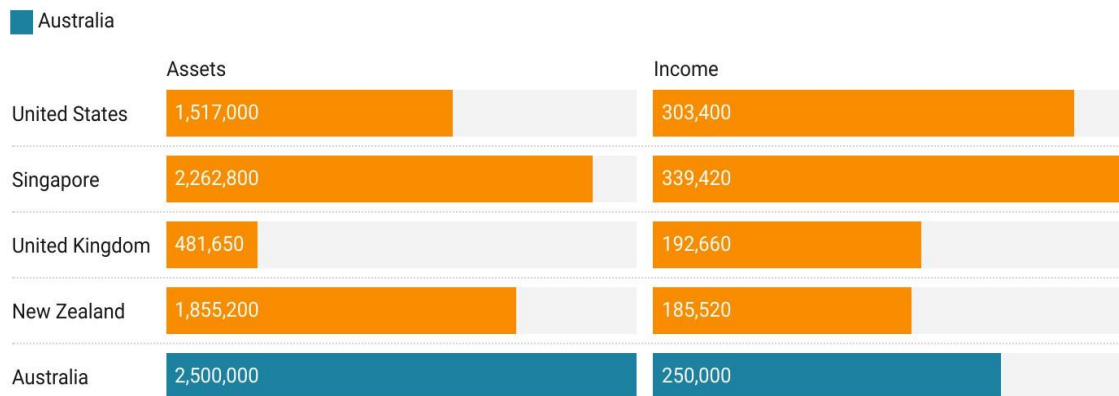


Chart: Brisbane Angels • Source: BA Research • Created with Datawrapper

Figure 1: International Benchmarks

As illustrated in Figure 1, Australia's existing financial thresholds align with international norms. Alterations that tighten these criteria could, however, dampen the competitive advantage of our burgeoning early-stage investment sector.

United States: The SEC reviewed the sophisticated investor issue recently and it is hard to believe legislation in Australia will be passed without this information being part of the debate. The US pioneered the concept of accredited/sophisticated investor. It has been adopted all around the world and the structure of the legislation is accepted best practice.

In August 2020, the Securities and Exchange Commission (SEC) broadened the definition of an 'accredited investor' (analogous to Australia's sophisticated investor) in Rule 215 and Rule 501(a) of Regulation D under the Securities Act of 1933, as amended (Securities Act).

The amendments allow more investors to take part in private offerings by adding new categories of individuals who may qualify as accredited investors based on their professional knowledge, experience or certifications. The amendments also expand the list of entities that may qualify as accredited investors by, among other things, allowing any entity that meets an investment test, rather than an asset test, to qualify. This expansion acknowledges that investment savvy is not just a function of wealth or income.

European Union: Under MiFID II, the EU advocates a comprehensive evaluation, assessing an investor's knowledge, experience, and financial situation to gauge their sophistication.

Singapore: The Monetary Authority of Singapore (MAS) employs a comprehensive approach, considering financial resources, investment experience, and product knowledge.

These global benchmarks show a shift towards a more inclusive, well-rounded criterion for investor sophistication, balancing financial capacity with the capability to understand and manage investment risks. The narrow focus on financial metrics oversimplifies the intricacies of investment decisions and represent a regression from this evolving international trend.

We advocate for an assessment system prioritizing investor education and informed decision-making over mere financial metrics. A framework that evaluates an investor's understanding of risk and decision-making aptitude would more effectively serve the market. Such a system would allow informed investors to take part, regardless of their financial background, aligning Australia more closely with progressive global standards.

Market Impact and Regulatory Considerations

Market Stability

At Brisbane Angels, we emphasize the critical importance of market stability for early-stage companies. The proposed alterations to the sophisticated investor thresholds in Australia raise significant concerns for us, particularly about their impact on this stability.

The existing thresholds have fostered a dynamic ecosystem. A broad range of investors contributes not only capital but also diverse perspectives, experiences, and networks. This diversity is invaluable for the growth of young companies.

Increasing the thresholds could exclude a vital segment of investors. The potential reduction in both funding and diversity of thought poses a risk to the support system crucial for early-stage ventures. The higher thresholds could disproportionately affect certain demographic groups, particularly women, leading to a less diverse investor base.

Sudden changes in investment criteria can create market uncertainty. This might result in a cautious approach from investors and entrepreneurs, decelerating innovation and economic growth, particularly in sectors dependent on angel investment and venture capital.

Focusing solely on financial thresholds overlooks the complex dynamics of market stability. We advocate for a balanced approach that considers the broader market dynamics and the supportive environment necessary for the thriving of startups.

In conclusion, Brisbane Angels believes that a more comprehensive approach, one that balances financial criteria with the need to support a diverse and dynamic investment environment, is crucial for the continued growth and stability of the early-stage investment sector.

Regulatory Consistency

The Importance of Stable Regulations:

At Brisbane Angels, we emphasize the critical role of regulatory consistency in the investment sector. Predictable and stable regulations are fundamental in building investor confidence and fostering a robust investment environment. The proposed amendments to the sophisticated investor thresholds, however, pose a risk of disrupting this much-needed consistency.

Abrupt Regulatory Change:

Abrupt alterations in investment criteria can cause confusion and uncertainty. Investors have long adapted to the existing thresholds, shaping their strategies accordingly. Any substantial change could need a reassessment of these strategies, potentially leading to a period of market hesitancy and adjustment.

Consistent regulations are crucial for long-term investment planning. They enable investors to commit to long-term strategies vital for nurturing early-stage ventures. Similarly, entrepreneurs depend on this consistency to navigate the investor landscape and devise effective fundraising strategies.

Broader Impact on the Investment Ecosystem:

The primary goal of the accredited investor definition is to show clear, definitive criteria that enable market participants to easily ascertain an investor's eligibility. A clear and certain accredited investor definition enhances trust in unregistered markets, which could lead to lower capital costs and encourage more capital investment, especially helping small businesses.

A sudden shift in investor classification criteria might inadvertently introduce regulatory instability. Not only affecting current investors but also potentially diminishing the Australian market's appeal to international investors.

In advocating for keeping the current thresholds, our aim is to preserve a regulatory environment that is consistent, predictable, and favourable for investment and innovation.

While periodic reviews and updates of regulations are necessary, we argue that such changes should be implemented with a keen awareness of their long-term implications on market stability and investor confidence.

Investor Autonomy

At Brisbane Angels, we staunchly support preserving investor autonomy, a principle effectively upheld by the current sophisticated investor thresholds. The suggestion to elevate these thresholds significantly worries us, as it might restrict the decision-making freedom of individual investors.

The existing thresholds enable a wide range of investors to take part in various investment opportunities and are capable of understanding and shouldering the risks linked with sophisticated investments.

Raising the financial criteria may impede this autonomy, curtailing many competent investors' abilities to partake in investments they consider appropriate.

Investor Protection and Autonomy:

While investor protection is a cornerstone of financial regulation, it should not lead to overly restrictive measures that hamper investor choice. Investors who are well-informed ought to have the liberty to make decisions based on their risk-reward assessment, regardless of their wealth or income.

The current criteria also provide an avenue for emerging sophisticated investors to access a broader range of investment choices, promoting financial growth and literacy. This encourages investors to enhance their understanding and experience in the financial markets.

In conclusion, as Brisbane Angels, we view keeping the current thresholds as crucial to preserving investor autonomy. Our advocacy is for a regulatory framework that strikes a balance between safeguarding investors and empowering them, ensuring the freedom to make informed choices within a diverse investment landscape.

Economic Implications

As Brisbane Angels, our understanding of the investment landscape extends beyond immediate financial returns and our own investment portfolios; we are acutely aware of the broader economic implications of any regulatory changes.

The proposed increase in thresholds could have far-reaching consequences for the Australian economy, particularly in the sectors reliant on angel investments and venture capital.

Startups and early-stage companies, often the drivers of innovation and job creation, depend heavily on investments from a diverse range of sophisticated investors. By potentially reducing the pool of these investors, the proposed changes risk curtailing the flow of capital to these vital sectors.

We have seen that the existing thresholds have allowed a diverse group of investors to take part in early-stage investments, which is vital for the development of startups and emerging businesses. The proposal to double these thresholds could potentially exclude a sizeable part of this investor base, leading to a reduced flow of capital to these innovative ventures.

Moreover, the changes could affect the overall investment climate in Australia. A vibrant and inclusive investment environment is essential for attracting both domestic and international capital. Restrictive thresholds not only deter domestic investors but also make Australia less attractive for international investors, who often look for markets with a dynamic and diverse investment ecosystem.

In our view, it is crucial to assess the proposed changes not just from a regulatory standpoint but also from an economic perspective. The thresholds for sophisticated investors should facilitate a healthy flow of capital to all sectors, supporting economic growth and innovation. Therefore, we advocate for keeping the current thresholds, or at least considering a more gradual approach to any changes, to avoid any sudden disruption to the economic ecosystem.

Conclusion

In conclusion, our perspective is rooted in the necessity of supporting a delicate balance between safeguarding investors and ensuring a vibrant, dynamic investment environment. We caution against changes that could inadvertently hinder the flow of capital to sectors that drive innovation and suggest a more nuanced approach that prioritises investor education and informed decision-making.

Our analysis, grounded in our experience and understanding of the investment landscape, leads us to conclude that the proposed doubling of financial thresholds could have unintended consequences. These include reduced investment flow to early-stage companies, diminished

investor autonomy, and potential negative impacts on the economic vitality of sectors crucial for innovation and growth.

We also recognize the importance of aligning with international trends, which are moving towards more inclusive and holistic criteria for investor sophistication. In this light, the proposed changes, with their emphasis on financial capacity alone, seem out of step with the global movement towards recognising a broader range of investor qualifications.

Our stance is clear: keeping the current thresholds (or adopting a more nuanced approach to any changes) is imperative to preserve a dynamic, inclusive, and stable investment environment.

Such an approach not only protects investors but also ensures the continued flow of capital to innovative ventures, supporting the overall health and competitiveness of Australia's economy.