

Thursday, 16 May 2024

Committee Secretary
Parliamentary Joint Committee on Corporations and Financial Services
PO Box 6100
Parliament House
Canberra ACT 2600

Submitted via email: corporations.joint@aph.gov.au

Dear Sir/Madam,

Inquiry into wholesale investor and wholesale client tests

Chartered Accountants Australia & New Zealand (CA ANZ), CPA Australia, the Institute of Public Accountants and the SMSF Association (the Joint Associations) welcome the opportunity to provide comments to the above inquiry.

The Joint Associations support a strong regulatory framework that seeks to improve investor outcomes, promote investor confidence, and maintain financial stability while supporting choice, competition, and innovation in the market.

As part of a strong regulatory framework, we believe there are amendments that could be made to the current wholesale and sophisticated investor client tests, particularly the thresholds for each of the tests, which have not been amended since first being implemented over two decades ago.

Our recommendations are summarised as follows:

- Remove the requirements for the provision of accountants' certificates
- Increase the product value test to \$1 million and index in line with Average Weekly Ordinary Times Earnings (AWOTE) in \$100,000 increments
- Increase the net assets test of the individual wealth test to \$4 million and index in line with AWOTE in \$250,000 increments
- Exclude an individual's principal place of residence from the net assets test
- Increase the gross income test threshold to \$350,000 and index in line with AWOTE in \$25,000 increments.
- The gross income financial threshold should exclude capital gains, employment termination payments and franking credits
- Introduce the requirement for individual consent to be treated as a wholesale investor or client.

Our detailed responses are contained in the Attachment.

For any questions in relation to this submission, please contact Michael Davison, Financial Advice Leader, Chartered Accountants Australia & New Zealand at michael.davison@charteredaccountantsanz.com.

Sincerely,

Tony Negline

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Attachment

The development of the wholesale investor and wholesale client tests

The current wholesale investor/client tests – the product value test and individual wealth test – were introduced by the *Financial Services Reform Act 2001* (FSR Act) amendments incorporated in the *Corporations Act 2001*.

Although the FSR Act received Royal Assent more than twenty years ago, the initial thresholds of \$500,000 for the product value test and \$2.5 million in assets or gross income of \$250,000 per annum for each of the last two financial years for the individual wealth test have not increased in that period.

In 2011, the *Wholesale and Retail Clients Future of Financial Advice Options Paper*¹ stated the level of the product value test of \$500,000 was considered a low level and within the reach of an increasing number of Australians, given that the median value of a house in Australia in June 2010 was \$558,540. As a comparison, the median capital city house price in March 2024 was \$1,112,575².

The individual wealth tests were originally included, since high net wealth often coincides with high financial literacy. However, higher financial literacy is more likely to result from actual experience with transactions involving financial products³. Correspondingly, high wealth in illiquid assets may not reflect a high level of knowledge about financial assets by an individual.

When first implemented, it was assumed that approximately 2 per cent of Australian adults in 2002 would meet the individual wealth tests, however this had grown to 16 percent in 2021. If unchanged, modelling predicts this will increase to 29 per cent by 2031 and 44 per cent by 2041⁴. The large increase in individual wealth has largely been driven by the increase in residential property values, as mentioned above.

Amending the wholesale investor/client tests

The Joint Associations believe that amendments could be made to the current wholesale investor/client tests, particularly as these have not been amended since first being implemented over two decades ago.

¹ [Wholesale and Retail Clients Future of Financial Advice Options Paper](#), January 2011, p.5

² Domain, [March 2024 House Price Report](#)

³ Lusardi, A. and Mitchell, O.S. (2013) 'The economic importance of Financial Literacy: Theory and Evidence', *Journal of Economic Literature*, 52(1), pp. 5–44. doi:10.2139/ssrn.2243635.

⁴ B Phillips (2021), [Sophisticated Investor Projections](#), ANU Centre for Social Research and Methods, p 8.

Product value test

The Joint Associations recommend that the product value test be increased to \$1 million and indexed in line with Average Weekly Ordinary Times Earnings (AWOTE), but only increased in \$100,000 increments.

Examples such as Mayfair 101, who took advantage of the product value test to avoid disclosure obligations and inappropriately marketed their investments as a similar risk profile to bank term deposits⁵, demonstrate the need to increase the product value test to ensure appropriate consumer protection mechanisms are in place.

An indexing mechanism for the threshold will also ensure the test remains relevant into the future.

Individual wealth test

The financial thresholds for both the net assets and gross income tests should be increased, noting again that neither threshold has been increased since implementation.

Net assets test

The Joint Associations recommend that the net assets test be increased to \$4 million to reflect the impact of increases in asset values, inflation and wages since the threshold was first introduced. As an example, \$2.5 million invested in the All Ordinaries Index in March 2002 (the commencement date of the FSR Act) would now be worth over \$5 million in April 2024. The threshold should also be indexed in line with AWOTE, but only increase in \$250,000 increments.

The individual's principal place of residence should be excluded when determining their net assets for the purposes of the individual wealth test, as it is not an asset an individual should risk having to realise should their other investments fail. Further, for some individuals it may be their only significant asset and therefore arbitrarily inflate their financial wealth position or dealings with financial products. An individual's superannuation benefits that are subject to preservation should also be excluded, as the individual does not have access to these benefits at the time of determining if they meet the individual wealth test.

Gross income test

The Joint Associations recommend that the gross income financial threshold be increased to \$350,000 and indexed in line with AWOTE, but only increased in \$25,000 increments.

⁵ [ASIC investigation into Mayfair 101](#), 10 October 2022

Certificates issues by a qualified accountant

A key part of the individual wealth test is the provision of a certificate issued by a qualified accountant (accountants' certificates) verifying that the individual meets one or both of the tests.

However, the Joint Associations believe accountants' certificates are no longer fit for purpose and should be removed.

The adviser or product issuer should be responsible for ensuring that it is appropriate for a client to invest outside the retail client protections. Members across our associations are reporting a significant increase in requests for certificates, from both clients and, increasingly, non-clients.

The increased use and reliance upon accountants' certificates are deeply concerning. Recent matters managed by Australian Financial Complaints Authority (AFCA) have highlighted the overreliance, by some, on accountants' certificates. There is a perception that the holding of an accountant's certificate removes risk for the advisor or product provider and instead, shifts that risk to accountants.

The existing retail client compliance burden is seeing a growing trend in the use of the wholesale and sophisticated investor regimes as a means of alleviating regulatory burden and hence reduce business operating and client acquisition costs. This should occur only where it is appropriate in the client's circumstances.

The legislative framework for the provision of financial advice has significantly changed since the wholesale and sophisticated investor regimes were first introduced. Unless an accountant is licensed to provide financial advice, they are prohibited from providing personal financial advice. This includes advice to not invest in or dispose of a financial product.

This is problematic where it is clear to an accountant that it is inappropriate for a client to be moved away from the retail client environment. A conflict arises as the accountant has a duty to act in the best interests of the client and comply with Accounting Professional Ethical Standards Board APES 110 *Code of Ethics for Professional Accountants*.

Where there are no avenues available to clients for compensation, any litigation for damages can be awarded against the accountant, requiring access to their professional indemnity (PI) insurance. Noting that not all PI policies will insure accountants for the provision of this service, we are justifiably concerned that the quantum of contingent liabilities residing in the system is significantly high. Despite the intention that accountant's certificates are to be a pure statement of fact, the risk to accountants is high, and the interaction of the law and their obligations highly complex.

In line with other professions, the determination of whether a client satisfies the requisite financial threshold and has the appropriate knowledge, experience and risk appetite, should be made by either the adviser making the recommendation, or the product issuer.

Individual consent to be treated as a wholesale investor/client

The Quality of Advice review recommended clients provide written consent to be treated as a wholesale client.⁶

The Joint Associations support the introduction of consent requirements which would clarify that a client must specifically acknowledge instances when they will be classed as a wholesale client and ensure that they understand they will not receive the benefit of protections provided to retail clients.

This would ensure that clients are more engaged in their financial product investments, and more aware of the protections and disclosures to which they are specifically entitled. Advisers and intermediaries would also be held to a higher standard of care and required to provide more frank and open communication with their client about their legal entitlements.

The obligation on the adviser or intermediary should be to obtain informed written consent from their client before any financial product advice or service is provided.

A standard opt-in form should be developed, written in plain English, to ensure consistency and transparency of the important information the client should be aware of, before considering if they should provide written informed consent.

The form should clearly state the consequences of being treated as a wholesale client, including:

- the adviser is not required to comply with the professional standards applicable to financial advisers
- the adviser does not have a duty to act in the best interests of the client under the *Corporations Act 2001*
- the adviser is not required to provide the client a product disclosure statement, financial services guide or statement of advice, and
- the client will not be entitled to complain about the advice under the AFS licensee's internal dispute resolution procedures or to AFCA.

The need for this disclaimer also highlights a significant gap in the regulation of wholesale advisers.

Currently, there are no minimum education or training standards to be authorised as a wholesale adviser and as stated above, wholesale advisers do not have to comply with the best interests duty or the Code of Ethics.

⁶ [Quality of Advice Review report, 2022](#) – recommendation 11.

ASIC has also indicated that for the 2022-23 financial year, the cost of its regulatory oversight for the 1,931 entities providing only wholesale advice will be \$176,000 compared to an estimated \$48 million for 2,766 entities providing personal advice to retail clients on relevant financial products.

While outside of the scope of this review, we believe this demonstrates a clear regulatory gap that warrants a review of the investor protections and regulatory oversight for the wholesale advice sector.