

18 June 2013

Mr Greg Medcraft
Chairman
Australian Securities & Investments Commission
100 Market Street
Sydney NSW 2000

Dear Mr Medcraft,

Retail/Wholesale Client Definition
- ASIC QFS150

We would like to raise an important issue in relation to ASIC's view of the categorisation of Superannuation Funds – including Self-Managed Superannuation Funds (SMSFs) – as Retail Clients under the *Corporations Act*, and seek reconsideration by the Commission of this view.

ASIC's View – QFS150

In 2004, ASIC stated that in its view *all* Superannuation Funds (including SMSFs) with assets of less than \$10 million must always be treated as Retail Clients for the purpose of receiving advice¹.

This view has caused uncertainty in practice. We have previously raised this issue with the Commission, but the situation – and ASIC's view – remains unchanged². The confusion was acknowledged in Treasury's 2010 review of the Definitions of

¹ ASIC *Frequently Asked Question about Financial Services Regulation QFS150 – When financial services are provided to a trustee of a superannuation fund, are they provided to a retail client?* Published 25 November 2004 <http://www.asic.gov.au/asic/ASIC.NSF/ASIC+FSR+FAQ+DisplayW?ReadForm&unid=7BDE894D55A75B3BCA256F56007AEED1>

² For example, the issue was raised at the 23 March 2006 ASIC/SDIA Liaison Meeting

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Wholesale and Retail clients in the Act³. For example, it leads to the confusing situation where a person who controls \$9m of assets in the person's name or through a corporate entity may be classed as a **Wholesale** client, but if the same person held the same \$9m of assets in their SMSF, they would have to be taken to be a **Retail** client. This is clearly an anomalous situation for someone who should generally be taken to be financially sophisticated.

Growth of the SMSF Sector

The rapid growth of the SMSF sector over the past decade is well documented, and the subject of much financial commentary.

According to figures published by the Australian Tax Office in December 2011⁴, during the five years from **30 June 2005 to 30 June 2010**, SMSFs were the fastest growing sector of the Australian superannuation industry.

During this period:

- total super assets grew by 60%, and SMSF assets grew by 122%
- most of the total growth in super assets (46% of the 60%) was attributable to SMSFs
- the total value of SMSF assets grew from \$162bn to \$387bn, which is 30% of total super assets (\$1.3tr)
- the total number of SMSFs grew by 47%, from 289,615 to 425,300, and
- the total number of SMSF members grew by 46% from 556,666 to 810,450.

No doubt assisted by improved market conditions over the last year, this rapid growth has continued. According to the latest Quarterly report issued by the ATO, as at **March 2013**⁵:

- the total value of SMSF assets had risen to \$428bn
- the total number of SMSFs had risen to 503,320, and
- the total number of SMSF members had risen to 958,095.

³ Treasury *Future of Financial Advice: Wholesale and Retail Clients Options Paper January 2011* paragraph 8.2 page 24

⁴ ATO *Self-managed super funds: A statistical overview 2009* Published December 2011
<http://www.ato.gov.au/corporate/PrintFriendly.aspx?ms=corporate&menuid=0&doc=/content/00301485.htm&page=3&H3>

⁵ ATO *Self-managed super fund statistical report – March 2013*
<http://www.ato.gov.au/corporate/PrintFriendly.aspx?ms=corporate&menuid=0&doc=/content/00301485.htm&page=3&H3>

The rapid and continuing growth in SMSFs has been driven by investors taking more control of their investments. This has resulted in a growing pool of investors - who had previously left investment decisions to fund managers and super funds – who need professional advice. Accordingly, SMSFs are a key focus for our Members.

Legal Advice

Notwithstanding ASIC's previously expressed view, we are of the view that there are good legal arguments that the provision of advice to a SMSF trustee with less than \$10m in assets will not always involve the provision of advice to a retail client. The main problem with ASIC's view is that it states that the provision of advice to an SMSF trustee will always '*relate to a superannuation product*' under section 761G(6)(b). As our lawyers, **Middletons**, state in their advice of 22 March 2012:

'...the scope of section 761G(6)(b) may not be as wide as ASIC indicated back in 2004 and we are not convinced that the provision of advice to a SMSF trustee client about the acquisition of investments (such as securities) by the SMSF necessarily relates to a superannuation product.'

The grounds for Middletons' view are fully set out in the advice attached.

Accordingly, taking into account the growth of the SMSF sector, the passage of time since ASIC published its views in QFS150 in 2004, and strong legal arguments, we submit that ASIC should **revisit** its position, and adopt a view that is more consistent with the main Wholesale/Retail client definitions of the Act. The most commonly used definitions like the minimum assets or income test⁶ ought to apply to SMSF trustees as they do to any other client.

Yours sincerely



David W Horsfield
Managing Director/CEO

⁶ i.e. minimum \$2.5m net assets, or \$250,000 income for the past 2 years, certified by an accountant under s761G(7)(b)

22 March 2012

Our reference
GCLE.JB.10048870

By Email: dclark@stockbrokers.org.au

Doug Clark
Policy Executive
Stockbrokers Association of Australia
Level 6, 56 Pitt Street
Sydney NSW 2000

Dear Doug

Retail clients and SMSF trustees

We refer to your email of 16 February 2012.

1. Instructions

We understand that members of the Stockbrokers Association of Australia (**SAA**) have raised concerns that the views of the Australian Securities and Investments Commission (**ASIC**) about the characterisation of retail clients differ in some respects from the views of SAA and its members. In particular these views diverge in relation to:

- » the appropriate test for determining whether trustees of self-managed superannuation funds (**SMSFs**) are wholesale clients or retail clients within the meaning of the *Corporations Act 2001 (Cth)* (**Act**) when financial product advice is being provided; and
- » whether a person's superannuation entitlements may be taken into account for the purposes of the net assets test in sections 708(8)(c)(i) and 761G(7)(c)(i) of the Act.

2. Characterisation of SMSF trustees

Section 761G of the Act sets out a number of tests to determine whether a person receiving a financial product or financial service can be classified as a wholesale rather than a retail client.

2.1 Superannuation Product Test

Section 761G(6)(a) of the Act provides that, where a financial product that is provided to a person is a superannuation product, it is provided to a retail client. While the term "superannuation product" is not defined in the Act, Section 761E indicates that a "superannuation product" is issued to a person when that person becomes a member of a fund.

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In addition, section 761G(6)(b) of the Act provides that a financial service is provided to a person as a retail client if:

- » the financial service is other than the provision of a financial product; and
- » it relates to a superannuation product; and
- » the person to whom it is provided is not the trustee of a superannuation fund that has net assets of \$10 million or more.

The net asset position of a fund is obviously an objective determination but the other two components of the Superannuation Product Test have caused some difficulties for industry and commentators.

"Other than the provision of a financial product"

It appears that section 761G(6)(b) of the Act is intended to capture any financial service other than the issue of a financial product, while the issue of an interest in a superannuation fund will be caught by paragraph (a). As such, there is no doubt that the provision of financial product advice will be a service that is caught by paragraph (b) where it "relates to a superannuation product".

"Relates to a superannuation product"

There is no doubt that uncertainty remains around the meaning of "relates to a superannuation product". The "Future of Financial Advice - Wholesale and Retail Client Options Paper January 2011" (**Options Paper**) indicates that clarification of the phrase may be needed and states that:

"There is currently some confusion regarding whether "in relation to a superannuation product" in s761G applies to financial services and product made available to the trustee of a superannuation fund (other than superannuation products)."

ASIC has previously attempted to clarify this issue in its Frequently Asked Questions.

ASIC QFS 150 issued in 2004, indicates a view that all financial advice provided to a SMSF trustee "relates to a superannuation product" and is therefore provided to a retail client if the SMSF has assets of less than \$10 million. ASIC uses the example of a trustee of a superannuation fund seeking advice about which assets it should hold. It states that, where this advice is provided to a trustee of a SMSF that has net assets of less than \$10 million, it is provided to a retail client.

Notwithstanding ASIC's stated view in QFS 150, we consider that there are respectable arguments that the provision of advice to a SMSF trustee about the acquisition of financial products will not always "relate to a superannuation product".

In our view, section 761G(6)(a) of the Act was intended to ensure that people acquiring or disposing of a superannuation product, would always be treated by the issuer of the product as a retail client. Similarly section 761G(6)(b) would ensure that other financial services including advice which relates to the acquisition or disposal of a "superannuation product" is provided to a retail client.

However we agree with the observations made in the Options Paper that the scope of section 761G(6) (b) may not be as wide as ASIC indicated back in 2004 and we are not convinced that the provision of advice to a SMSF trustee client about the acquisition of investments (such as securities) by the SMSF necessarily relates to a superannuation product. We consider that this view is supported by the following.

- » When financial products (such as securities) are issued to a SMSF trustee as investments, the Superannuation Product Test will not deem them to be retail clients as section 761G(6)(a) only applies to the issue of superannuation products and section 761G(6)(b) does not apply to the provision of a financial product. Accordingly, we consider it unlikely that Parliament would have intended that advice about such investments should be caught by the Superannuation Product Test.
- » If ASIC's view as to the meaning of section 761G(6)(b) were correct, that section could simply have been drafted to apply whenever financial services are provided to a SMSF trustee. The section has not been drafted this way and we consider that this demonstrates Parliament's intention for section 761G(6)(b) to have a more limited application than that propounded by ASIC.

Accordingly, we would say that the correct view is that a client should be characterised as a retail client under the Superannuation Product Test only where advice provided by a financial services licensee to a trustee or member of a SMSF relates to the issue, acquisition or disposal of the superannuation product.

In circumstances where the Superannuation Product Test does not apply, it is still necessary to apply the remaining wholesale / retail client tests to the SMSF trustee.

2.2 Value Test

Section 761G(7)(c) of the Act provides that if a financial product is not, or a financial service does not relate to, a general insurance product or a superannuation product the product or service will be provided to a retail client if the price for the provision of the product to which the service relates is less than \$500,000.

It would follow that if advice is provided to a SMSF trustee and relates to, for example, the acquisition of interests in a managed investment scheme valued at more than \$500,000, it will be provided to a wholesale client.

However, subregulation 7.1.26 of the *Corporations Regulations 2001* (Cth) (**Regulations**) provides that, in assessing the price of a financial product, superannuation-sourced money cannot be counted towards the \$500,000 threshold if the service being provided is financial product advice.

SMSF trustees acquiring interests in a managed fund for investment purposes would be using superannuation-sourced monies to do so. Accordingly, this regulation would prevent a financial services licensee from characterising a SMSF trustee as a wholesale client on this basis.

2.3 Assets / income test

The next test that may be applied is set out in section 761G(7)(b) of the Act which provides that advice will be provided to a wholesale client if:

- » the client has net assets of at least \$2.5 million (and provides an accountant's certification of this prior to the advice); or
- » the client has had gross income for each of the last 2 financial years of at least \$250,000 per year (and provides an accountant's certification of this prior to the advice).

Section 761FA of the Act, entitled "Meaning of person – generally includes multiple trustees" provides that where a trust (such as a SMSF) has, or has in the past had 2 or more trustees, they, together with the trust itself, are to be treated as one entity. This suggests that the client, for the purposes of section 761G(7)(b) of the Act, is the trustees together. Accordingly, if the sum of the value of the assets of the SMSF's two trustees is at least \$2.5 million, or the combined income of those entities has been at least \$250,000 per year for each of the last 2 financial years, the SMSF may be treated as a wholesale client.

However, given that section 761FA of the Act only applies where the SMSF has, or has had, multiple trustees, it does not appear that the assets or income of directors of a corporate trustee can be pooled for the purposes of these tests.

Alternatively, subregulation 7.6.02AB of the Regulations modifies section 761G(7)(c) of the Act to provide that where the client is a trustee (such as a SMSF trustee), the financial product advice will be provided to a wholesale client if:

- » a person who controls the SMSF has net assets of at least \$2.5 million (and provides an accountant's certification of this prior to the advice); or
- » a person who controls the SMSF has had gross income for each of the last 2 financial years of at least \$250,000 per year (and provides an accountant's certification of this prior to the advice).

Control is defined in section 50AA of the Act. This section states that a person will control an entity if it has the capacity to determine the outcome of decisions about the entity's policies. However, section 50AA(3) of the Act states that a person will not control an entity merely because it and another person jointly have the capacity to determine the outcome of such decisions.

Pursuant to this definition, there will only be one person who controls a SMSF if:

- » a SMSF has only one member, with a corporate trustee that has a sole director; or
- » there are two or more individual trustees, who can be treated as one under section 761FA of the Act as discussed above.

Sections 17A and 17B of the *Superannuation Industry (Supervision) Act 1993 (Cth)* require all members of a SMSF to be directors of the corporate trustee, or trustees where

the SMSF has individual trustees. Further, where the SMSF has only one member and it is required to have two trustees or a corporate trustee.

The apparent conclusion is that a SMSF with more than one trustee and a SMSF that has one member and a sole director corporate trustee are capable of being characterised as wholesale investors. On the other hand, a SMSF with a corporate trustee that has more than one member is not capable of being characterised as a wholesale investor by this test.

There is no policy reason for this distinction and we do not consider that this outcome was the intention of the legislature. Further, this outcome is not contemplated by the Explanatory Information relating to the introduction of the "controller of a trust" test discussed above.

For the reasons discussed in paragraph 3 below, however, we do not consider that this distinction will be a significant practical issue for SAA members in circumstances where they are in receipt of a certificate provided by a qualified accountant.

2.4 Conclusion

We consider that there are widely acknowledged arguments that the Superannuation Product Test will not apply to deem all SMSF trustees of funds with less than \$10 million in assets as retail clients in respect of the provision of all types of financial product advice. The wording of the Superannuation Product Test does not indicate that any advice provided to a SMSF trustee will "relate to a superannuation product". If this was the intention, the drafting of the Superannuation Product Test would have been different.

Similarly, given that a strict application of the assets / income test gives rise to some anomalous results, there are respectable arguments for the proposition that the intention of the legislature was to allow the assets or income of individual SMSF trustees and of the directors of corporate SMSF trustees (whether one or more) to be taken into account for the purposes of this test.

In any event, for the reasons discussed in paragraph 3 below, we consider that it is open to members of the SAA to rely on any accountant's certificates that they are provided with as to the wholesale status of a SMSF.

3. Including superannuation in section 761G(7)(c)(i) test

Neither the Act nor the Regulations contain any guidance as to what may be included in a calculation of a person's "net assets" for the purposes of determining whether they are a wholesale client under section 761G(7)(c)(i) of the Act or, in the securities context, determining whether they are a "sophisticated investor" under section 708(8)(c)(i). Accordingly, the ordinary definition of net assets should be used. In our view this would include a person's superannuation, in which a person has property and sole beneficial ownership.

We note that the Options Paper suggests ideas for reforming the law distinguishing between retail and wholesale clients and proposes the exclusion of "illiquid assets" from a determination of the net assets of a person. The Options Paper specifically refers to

superannuation as an example of an illiquid asset that could be excluded by the proposed amendment. This suggests that the current position is that these assets are to be taken into account when assessing a client's wealth for this purpose.

In any event, all that is necessary for the tests in section 708(8)(c) and 761G(7)(c)(i) to be made out is that a certificate has been provided by a qualified accountant and that the certificate states that the client has the requisite level of "net assets". In circumstances where an SAA member has received such a certificate, we do not consider that it is necessary for the SAA member to make further inquiries as to the basis on which the certificate was prepared. This is purely a matter for the accountant providing the certificate.

Yours sincerely

A handwritten signature in blue ink, appearing to read 'Jim Bulling', with a stylized flourish at the end.

Jim Bulling
Partner