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Dear Dr Sandlant,

Wholesale and Retail Clients – Future of Financial Advice
Options Paper – January 2011

We refer to the above mentioned paper and request your consideration of the following feedback and comments.

Option 1 – Retain and update the current system

Update the Product Thresholds

It is proposed that one possible step would be to increase the product threshold from \$500k to \$1m to take into account the time value of money as there are now an increasing number of investors who are able to meet this requirement and who are not considered to be financially savvy.

We are a medium sized broker and account for approximately 1% of the trades on the ASX and help clients with a total of approximately \$1b of portfolio funds. We also provide wealth management services to our clients and so provide advice in relation to a number of asset classes. There are only a few of our clients who would satisfy the product test who would not also satisfy the business test. For clients that have \$500k available to invest, we recommend a range of financial products across the asset classes; so it would not come down to a question of investing that amount of money in one product. More specific to our situation, we have two main wholesale investment products. Both are managed investment trusts that are available only to wholesale investors. Each trust's investments comprise a portfolio of listed equities and managed funds held for the medium to long term with the object of capital growth and dividend income. One portfolio is of Australian shares held mainly in the ASX 200 and some managed funds, and the other is of international blue chip shares held in industries that are not well represented here in Australia and some managed funds. These are conservative investment and share portfolios and the underlying listed investments are subject to the continuous disclosure rules. A unit holder in either of these two trusts gets the immediate benefit of diversification and also enables them to compete on the same basis as institutional investors. We have not had occasion to use the \$500k product rule because a recommended allocation to a client into either of the two trusts has not come up to that amount. Our point here is that these are not fly-by-night risky products and we are being sensible about what we recommend to our clients.

Further, we do not think an increase to \$1m is justified. Taking into account a long term inflation rate of 2.5%¹, then \$500k adjusted for the time value of money is approximately \$820k². However, as the financial literacy of Australians increases, the wholesale client status should be available to a greater part of the population and as such there should be an offset against the increase resulting from the time value

¹ The RBA target inflation rate is between 2 – 3 percent, on average over a cycle.

² $\$500,000 \times (1.025)^{20} = \$819,308$.

adjustment. Based on this it may be that there should not be any adjustment at all. Further, as is pointed out in the Options Paper, any number would be an arbitrary number and, despite the GFC and cases like the *Lehman v. City of Swan and Ors*, the existing number of \$500k seems to have had the desired effect. I find it difficult to believe that the City of Swan and Ors invested in CDO's for as little as 120 basis points above the cash rate, (considering the risk), but they would have been relying to a great extent on the AA rating from S&P – which was quite a serious issue in itself. That is, the fault lay more at the feet of the product providers, who should have made better disclosure as to the risks, and ratings providers, than with the investors.

To summarise:

We do not think that an objective test is preferable to a subjective test or vice versa. Both tests have some warts but the existing ability to use one or the other is preferable to deleting either one of them. The objective tests are good because they are simple and easy to use, but the numbers are arbitrary. They may also not be an accurate guide to an investor's financial literacy. However, that is overcome by the ability to use the subjective test if a financially savvy investor cannot jump over the objective bars.

We do not agree with raising any of the three bars as this would (a) severely limit the ability of small to mid-cap companies having access to these categories of investors for capital transformation, and (b) the process of raising capital will become more costly, require greater administration, and increase the compliance burden, and (c) we may lose available capital to overseas markets.

No, we do not think \$1m is an appropriate new threshold for the reasons provided above.

Introduce an indexing mechanism

As above, whilst there is some argument for adjusting the quantitative limits for the effects of inflation, we feel that there is also some reasoning for an offset adjustment for the general public's increased investing awareness and education. This is evidenced by the rapid growth in the number of self managed superannuation funds, where people are keen to become involved in the investments that are going to provide a means of living in their retirement. It also reflects recognition of the investment in education that the Government is making so that the public are better equipped to make financial investment decisions and recognise value and avoid rorts and shonky schemes.

If indexing is implemented, then it should fit with the current sophisticated investor renewal period of 2 years; otherwise the process will become too burdensome.

Exclude Illiquid Assets

We don't agree that illiquid assets should be excluded from the objective tests. This is especially the case in regard to superannuation and or the family home, where the product, fund or home is the result of the decision to invest in that asset class. That is, it is the destination of the investment and might as easily have been made into direct equities or fixed interest, for example, as being made into superannuation (which could then be directed in any of the other asset classes), or the home. It is granted that a high net worth is not necessarily a true indication of financial literacy in some cases, but the reverse is also true in that a lack of wealth, where it is still being built, is not an indication that an investor is financially illiterate. Also, excluding superannuation because "some clients do not engage with their superannuation savings" is not fair on the growing numbers who do. Further, as is pointed out in the Options Paper: (a) to exclude the family home gives unfair advantage to those people who rent rather than own, and (b) to exclude superannuation may disadvantage some self employed people.

Amend the Deeming Process

We don't agree that a client should be deemed to be a wholesale client without their knowledge at the time an investment is made. If a deeming is made, then the client should be made aware of this at the time or as soon as practicable thereafter, (say within 5 business days). This would give the client the opportunity of opting out of the wholesale category and back into retail.

Two out of Three Requirements

Again, we don't agree with this suggestion because it would disadvantage investors either: (a) heavy in growth assets that generate a low income, or (b) with high incomes and on their way to being asset rich.

Introduce extra requirements for certain complex products

We agree that additional requirements should be in place for complex products. Firstly we believe that an adviser has a responsibility to advise to invest only an appropriately prudent allocation into complex products. Further, the workings and risks of the product(s) should be fully explained to the client and the client must

acknowledge that they understand these workings and risks. In order to do this perhaps the same requirements to give an SOA to retail clients should be brought into the wholesale arena for complex products.

Repeal the 'Sophisticated Investor' Test

We do not agree with the suggestion to repeal the sophisticated investor test that exists in section 761GA CA. This subjective test works to overcome the shortcomings of the objective product, assets and incomes tests, and therefore should remain in place. The reverse is also true in that the objective tests overcome the shortcomings of the subjective test.

It is true that the liability potential can restrict the use of the subjective test, but that is a good thing because it should ensure that the licensee only gives an acknowledgement in cases where they are sure that the client is financially sophisticated and understands the products or service being recommended.

Option 2 – Remove the Distinction between wholesale and retail clients

The distinction should not be removed as we believe it will:

- reduce the ability of a section of the investor population from being able to get access to certain capital raisings,
- restrict the ability of small to mid-cap companies to raise capital in an efficient and cost effective manner,
- impair wholesale investors access to other wholesale investor products and services,
- provide protection to wholesale investors that is not needed,
- lead capital seeking entities to look to overseas jurisdictions where the distinction is in place to raise capital,
- lead wholesale investors to look to overseas jurisdictions where the distinction is in place to invest capital,
- increase the administrative and compliance burden on capital seeking entities, investors and intermediaries.

In summary, we believe removing the distinction would be burdensome and inefficient.

Option 3 – Introduce a 'sophisticated investor' test as the sole way to distinguish between wholesale and retail clients

As said above we believe both the objective and subjective tests should remain in place as they are both used under different circumstances and therefore cover a wider number of instances. Neither type of test is perfect, but we feel that the availability of a choice of two types of test is better than having one and not the other.

Option 4 – Do Nothing

We agree with this option in most of the choices in Options 1 to 3 for the reasons already given. We see very little wrong with the existing system and the limits that are in place today. We feel it is the responsibility of advisers to make appropriate strategic allocations and recommendations in relation to all financial products in an investor's portfolio so that more risky and complex products receive smaller allocations.

New Test – Percentage of investable assets

There are two key issues we raise for consideration:

- 1) Most cases in the public domain arise from investors placing a disproportionate part of their wealth in one investment or one structured portfolio.
The Wholesale/Retail distinction is not the real issue. The real issue is the lack of a Corporations law requirement that says if any investor places more than, say, 15% of their investible assets in one investment or structure portfolio, then an increased level of regulation should be required. This would most likely be in the form of an SOA from a financial advisor / financial advisory firm independent of the investment.
- 2) Listed investments on recognised stock exchanges are subject to the continuous disclosure laws. That continuous disclosure means the market is informed and market prices protect the investor by

responding to publicly available information. This fact is recognised by the Corporations law no longer requiring a PDS for a rights issue. Similarly, a block on sophisticated investors obtaining access to placements of listed companies or diversified funds comprising listed securities (i.e. meeting the 15% test in 1. above) will simply exclude SMSF's and other sophisticated investors from the placement market. This is not in the public interest. There should be a carve-out for listed investments subject to continuous disclosure and wholesale funds comprising such investments.

We thank you for the opportunity of participating in this consultative process and would be pleased to discuss this further at your convenience. My telephone direct line is (07) 3006 7255.

Yours sincerely,

Burrell Stockbroking Pty Ltd

A handwritten signature in black ink that reads "Chris Burrell". The signature is fluid and cursive, with a long, sweeping tail that extends to the right.

Chris Burrell

MFM, BCom (Hons), LLB (Hons), FCA, SF Fin, MSAA
Managing Director