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15 May 2024

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

By email: corporations.joint@aph.gov.au

Dear Committee Secretary

We welcome the opportunity to submit a response to the Parliamentary Joint Committee on Corporations and Financial Services' (the **Committee**) inquiry into the wholesale investor test and wholesale client test (collectively referred to as the **wholesale investor/client tests**), released in March 2024 (the **Inquiry**).

The Inquiry addresses several aspects of the wholesale client tests applicable to fundraising under Chapter 6D of the *Corporations Act 2001* (Cth) (the **Act**) and financial services under Chapter 7 of the Act.

Our submission intends to contribute to the development of the law applicable to the wholesale investor/client tests under these chapters, drawing on the significant experience of Hamilton Locke's Funds and Financial Services team.

Yours faithfully

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Submission Paper

In response to the Terms of Reference for the inquiry into wholesale investor and wholesale client tests

About Hamilton Locke - Funds and Financial Services

Hamilton Locke is Australia's fastest growing law firm, which is focused on transforming the traditional approach to corporate and commercial legal services. Hamilton Locke is a full service offering corporate law firm, and as a part of the HPX Group, delivers essential corporate services across legal, governance, risk and compliance helping businesses grow and thrive.

Our Funds & Financial Services team are renowned specialists in providing regulatory, corporate and commercial advice to financial services and credit businesses nationally across the full spectrum of financial services.

Formed by a merger of boutique law firm, The Fold Legal with Hamilton Locke's investment funds team, the team boasts rankings for individual lawyers and as a group in Legal500 Asia Pacific Guide 2024 (Tier 3) for FinTech and Financial Services and both the Financial Services Regulation (Band 4) and Investment Funds (Band 4) categories in Chambers' Asia Pacific Guide 2024. We are currently ranked as a Band 2 firm in the Chambers's Fintech Legal Australia Guide.

Our clients include general insurers, underwriting agencies and insurance brokers, financial advisers and wealth management businesses, credit providers and mortgage brokers, retail and wholesale funds management businesses, licensed trustee companies, custodians, financial institutions and intermediaries, payment services providers, digital currency exchanges and fintech, blockchain/crypto and Insurtech businesses.

We are experts with financial services laws and ASIC, APRA and AUSTRAC regulation. We also act on behalf of our clients in regulatory investigations and enforcement actions.

Our financial services expertise is market leading, and we use our industry knowledge and expertise to deliver practical, compliant, and innovative solutions for our clients.

We are a partner and member of industry associations and regularly comment on law reform in the financial services segment including for FinTech Australia, Blockchain Australia and InsurTech Australia.

Executive Summary

We support the Committee's inquiry into the wholesale investor/client tests under section 708 of Chapter 6D and sections 761G and 761GA of the *Corporations Act 2001*(Cth) (**the Act**).

We believe that significant reforms are required to the wholesale investor/client tests in order to remain relevant and consistent with the original intent and purpose of the wholesale investor/client and retail distinction since it was first introduced in 2001.

The wholesale investor/client tests encompass the following:

- the net assets and gross income tests (collectively, the **individual wealth test**);
- the sophisticated investor test;
- the product value test;
- the professional investor test; and
- the small business test.

The original policy rationale and legislative intent for the differential treatment between wholesale investors/clients and retail clients, is that wholesale investors/clients are presumed to be "better informed and better able to assess the risks involved in financial transactions" or "possess the means to acquire appropriate advice", and therefore do not warrant the same level of protections as retail clients.[1]

Our Submission focuses on considerations for reform for the wholesale investor/client tests. Overall, we consider that if changes are not made to the wholesale investor/client tests there is a real risk that the provisions will continue to move further away from their legislative intent in drawing the distinction between retail and wholesale investors/clients.

We propose the following to ensure that the wholesale investor/client tests continue to remain relevant and consistent with the original policy intent:

- adjusted thresholds are required for the individual wealth and product value tests;
- the discounting of the value of the principal place of residence from net assets for the purpose of the individual wealth test;
- the creation of a rebuttable presumption that works in favour of prospective investors;
- the inclusion of alternatives to the small business test;
- addressing practical challenges of tying the design and distribution obligations and the product intervention powers to the retail client definition for credit products, including referring to product disclosure statements in the sophisticated investor test; and
- clarification of the availability of the individual wealth test for self-managed superannuation funds.

[1] Revised Explanatory Memorandum, Financial Services Reform Bill 2001 (Cth) [2.25], [6.27].

Submission

1. Adjusted thresholds are required for the Individual wealth and product value tests

Under sections 708 and 761G of the Act, a person will satisfy the individual wealth test where they have:

- net assets of $2.5 million; or
- a gross income of $250,000 per year over the last two years

and this is supported by a certificate provided by a qualified accountant.[2]

Under the product value test, a client who pays $500,000 or more for a financial product is considered to be a wholesale investor/client.[3]

These tests have not changed since they were first introduced in 2001. As a result, there has been an increase in the number of Australians that satisfy the individual wealth test to be considered a wholesale investor/client. A key factor is the significant rise in property prices and superannuation over the last two decades. According to the Reserve Bank of Australia's inflation calculator, $500,000 in 2001 would roughly equate to $852,931.32 in 2022.[4] Research undertaken by ANU's Centre for Social and Research Methods found that the percentage of investors that satisfied the wholesale investor/client tests in 2002 was 1.9% (285,000 people), in 2018 it increased to 12.1% (2.37 million).[5] It would be even larger now in 2024.

If the tests do not keep up with the changing economic conditions of today, there is a risk that those that genuinely require protections as retail clients will not have access to such protections. As a result, the regime is also shifting away from its original rationale for the differential treatment of wholesale investors/clients. Generally, wholesale investors/clients are presumed to be "better informed and better able to assess the risks involved in financial transactions", or "possess the means to acquire appropriate advice", and therefore do not warrant the same protections as retail clients.[6] However, given the number of Australians qualifying as wholesale investors/clients relative to their purchasing power in the current climate, this is not necessarily the case. Legislating for the individual wealth test and product value tests to be adjusted for the consumer price index (**CPI**), wage growth or some other appropriate growth index will ensure that the tests remain relevant where dollar amounts are used and is consistent with the legislative intent of the wholesale investor/client tests.

Accordingly, we consider that these thresholds for the individual wealth and the product value tests need to be adjusted and indexed so that both remain current. The law should be amended to ensure that amounts will be automatically indexed annually in line with the CPI, wage growth or some other appropriate growth index.

However, we are cognisant that adjusting these thresholds could create additional issues around how persons who were previously wholesale investors/clients may be able to dispose of the products they acquired as wholesale clients, but for which they are now treated as retail clients, particularly if these assets were acquired inside, or are held on, platforms that do not service retail clients. For this purpose, we suggest that there be a grandfathering provision, so that any products acquired by a person as a wholesale client under the individual wealth or product value tests prior to the indexation be treated as wholesale for the disposal of the same product, even if post-indexation they would otherwise be a retail client. In our view, any increased investment in, or new acquisition of, financial products should be subject to the new wholesale investor/client tests.

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[2] Section 708(8)(c) and 761G(7)(c) *Corporations Act 2001* (Cth).
[3] Section 708(8)(a),(b) and 761G(7)(a) *Corporations Act 2001 (*Cth).
[4] https://www.rba.gov.au/calculator/annualDecimal.html
[5] *Research Note: Sophisticated Investor Projections*, Associate Professor Ben Phillips, ANU Centre for Social Research and Methods (October 2021). We note that the research relied on the Household Income and Labor Dynamics Survey in Australia (**HILDA**) to undertake these projections.
[6] Revised Explanatory Memorandum, Financial Services Reform Bill 2001 (Cth) [2.25], [6.27].

2. Principal place of residence should be excluded from net assets

Additionally, we consider that in determining net assets for the purposes of the individual wealth test, a person's principal place of residence should be discounted. As noted above, the significant rise in property prices over the last two decades means that it is now relatively easier for a client to be deemed a wholesale investor/client due to the inflation of property prices.

Australia is quite unique in the way it captures the primary place of residence in the net assets test. For example, in jurisdictions such as the United States[7] and the United Kingdom[8] , their equivalent to our wholesale investor/client tests excludes the principal place of residence in determining net assets. In Singapore, consideration of the person's principal place of residence in calculating net assets is permitted only where and to the extent the value of that residence exceeds $1 million.[9]

In our view, discounting of the value of a individual investor's principal place of residence from the net assets test is appropriate because the distinction between retail and wholesale investors/clients is based on the premise that wholesale clients are more sophisticated investors with greater financial literacy and financial resources to be able to access advice, and therefore do not require the same protections as retail clients. However, where a person meets the individual wealth test wholly or partly based on the value of the primary residence, this does not necessarily mean they possess the financial literacy or knowledge of a wholesale investor/client (for example, if they have acquired that wealth purely through buying a residence and have held it for a long time and surpassed the threshold due to market conditions), nor does it mean they necessarily have the financial resources to be able to access advice.

Accordingly, we consider that a similar approach should be taken in Australia to the Singapore to ensure that individuals who need the protections of retail clients are not inappropriately captured by the wholesale investor/client tests. We consider that a $1.6 million threshold could be applied to any inclusion of the principal place of residence in the net assets test. That is, a person's principal place of residence may only be included to the extent the property's value exceeds a $1.6 million threshold. For example, if a person's primary residence had a value of $1.2 million, then their primary residence would be excluded from the calculation of the net assets test. If a person's primary residence had a value of $5 million, then $3.4 million may be counted towards the net assets test.

We suggest the $1.6 million threshold on the basis that this was the median house price in Sydney as of January 2024.[10] It is probable that persons who have wealth in a median or lower-priced house do not have surplus wealth, while persons who have wealth in a house that exceeds the median are more likely to have surplus wealth locked in the principal place of residence. We recognise that:

- this is an imperfect measure, as there may be anomalies on both sides of the median; and
- Sydney is not representative of all of Australia, as the median house price nationally is lower. However, we have selected Sydney as the highest of the property markets, as a lower threshold seems inappropriate and, in our view, risks too many vulnerable consumers being categorised as wholesale investors/clients. We note that Singapore's principal place of residence threshold is half of the asset value required to qualify as a sophisticated investor.

If $1.6 million is considered too low, then we suggest a principal place of residence threshold that is half of the net assets test. That number on the current test would be $1.25 million, but if the $2.5 million threshold is indexed using CPI, the threshold would increase to $4.5 million, in which case we suggest the principal place of residence threshold be $2.25 million. Any principal place of residence threshold should also be indexed annually in line with the CPI, wage growth or some other appropriate growth index.

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[7] See the U.S. definition of "accredited investor", U.S. Securities and Exchange Commission.
[8] See UK's Schedule 5 of the *Financial Services and Markets Act 2000 (Financial Promotion) Order 2005 No. 1529*
[9] See definition of "accredited investor" in Singapore under section 4A(1A) of the *Securities and Futures Act 2001.*
[10] '*Sydney's Median house price reaches a new peak of almost $1.6 million'*, Sydney Morning Herald, 24 January 2024.

3. Introduce a rebuttable presumption

Under the current regime, a financial product is presumed to be provided to a person as a retail client unless certain provisions are applicable or provide otherwise.[11] Currently, an individual can be classified under the individual wealth test and the product value test almost automatically if they satisfy the relevant asset test (subject to providing an accountant's certificate for the individual wealth test).

The challenge with these tests is that they presume that a person who can meet the specified thresholds has greater financial literacy and resources (such that they can access better advice) when this may not always be the case; for example, a person who is now classified as a wholesale investor/client because of a recent inheritance. The mere fact of receiving the inheritance says nothing about the person's relative financial literacy, despite the increased financial resources and capacity of the person. Their level of financial literacy may potentially limit their ability to source advice to support their decisions. Arguably, a person in this scenario should not be deprived of the retail client protections.

While the individual wealth test and the product value test are making a "presumption" about other characteristics of the client based on their financial resources, there is no reason this presumption could not be made rebuttable. That is, if a person meets the relevant thresholds, they may be presumed to be a wholesale investor, unless something else is known or should have been known to the licensee (if reasonable inquiries were made) to suggest that the person needs the retail client protections.

An analogous presumption that may assist here is section 13 of the National Credit Code (**NCC**), which creates a rebuttable presumption that a contract is not captured by the NCC where a debtor declares that the credit is to be applied for a non-Code purpose.[12] Put simply, the effect of a debtor signing a business purpose declaration in accordance with the NCC and corresponding regulation[13] is that it creates a presumption that the credit is not captured by the NCC and therefore, is not regulated credit. However, such a declaration is ineffective where the credit provider knew or had reason to believe or would have known or had reason to believe had the credit provider made reasonable inquiries about the purpose of obtaining the credit, that it was in fact to be applied for a Code purpose.[14]

We consider that meeting the individual wealth test and the product value test should create a rebuttable presumption which has a similar effect to that described above; in that the presumption that a client is a wholesale investor/client (because they satisfy one of the dollar thresholds to classify them as a wholesale investor/client) can be rebutted if the financial services provider knew or had reason to believe or would have known or had reason to believe if they made reasonable inquiries, for example, that the person may not understand the advice provided to them or have sufficient understanding of the financial product they are acquiring and therefore require retail client protection.

In such cases, it would not be enough that a person simply meets the individual wealth tests (either the net assets or gross income) or product value tests to be classified as a wholesale investor/client. A rebuttable presumption would place a greater onus on financial services providers to turn their minds to additional matters (other than the client's financial capacity or resources) to satisfy themselves that the client is in fact a wholesale investor/client.

We consider that such an approach would be consistent with the original intent of the wholesale investor/client and retail client distinction and ensure that individuals are afforded relevant retail client protections where they require it. This approach would also help protect investors from poor investment decisions and shift the responsibility on the financial services provider to determine whether their clients understand the nature of the financial products and services they are acquiring.

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[11] Section 708 and 761G of the *Corporations Act 2001*(Cth).
[12] That is, the credit is not intended for personal, domestic, or household purposes, to purchase or refinance credit for the purpose of renovating or improving residential property for investment purposes.
[13] Section 13 of the National Credit Code contained in Schedule 1 of the *National Consumer Credit and Protection Act 2009* (Cth); regulation 68 *National Consumer Credit Protection Regulations 2010* (Cth).
[14] Section 13(3) of the National Credit Code contained in Schedule 1 of the *National Consumer Credit Protection Act 2009* (Cth).

4. Include alternatives for the small business test

Section 761G(7)(b) of the Act presumes certain financial products or services[15] are provided to a person as a wholesale client if the product or service is provided for use in connection with a business that is not a small business. A "small business" is defined in the Act to mean a business employing less than 100 people where the business is engaged in the manufacture of goods, or otherwise less than 20 people (**small business test**).[16]

We consider that a multifactorial approach should be incorporated for the small business test to consider alternatives other than just the number of employees. Currently, a business may have a relatively low number of employees, but relatively high revenue or assets, and would still satisfy the definition of a small business and, therefore, the person acquiring the financial product or service in connection with that business would unlikely be considered a wholesale client.

A multifactorial approach to the small business test for the purposes of the wholesale investor/client and retail client distinction would be better suited because although it would have the effect of broadening the test for businesses, it would provide for a more nuanced approach that does not unnecessarily exclude those small businesses that do need the retail client protections.

We have considered tests such as those under the *Insurance Act 1973* (Cth) (**Insurance Act**) and the corresponding Insurance Regulations 2024 (**Insurance Regulations**). The Insurance Act and Insurance Regulations uses the concept of a "high-value insured" which is defined based on operating revenue, assets, or the number of employees.[17] A similar approach is also taken in the definition of a "small proprietary company" and "large proprietary company" in the Act, which is distinguished based on consolidated revenue, gross assets, and the number of employees.[18] We have not considered precisely what these threshold amounts should be in terms of revenue or assets, but, in our view, consideration should be given to the inclusion of these alternatives to the small business test.

5. Credit definitions are required

In general, credit facilities are excluded from the operation of the Act. [19] However, the introduction of the design and distribution obligations (**DDO**) and the product intervention powers (**PIP**) uses an "extended definition" of financial product that includes credit (both consumer and non-consumer credit).[20] This means that:

- the DDO apply to credit products provided to retail clients; and
- ASIC has PIPs in respect of credit products provided to retail clients.

Both are subject to various exemptions, however, we wish to focus on the retail client definition. In particular, the *National Credit and Consumer Protect Act 2009* (Cth) and the *National Credit Code* (collectively, **Credit Legislation**) do not have a concept of "retail" and "wholesale" clients and the definitions in the Act were never designed with credit products in mind. Instead, the Credit Legislation uses the concept of a "consumer", being "an individual or strata corporation to whom credit is provided for personal, domestic or household purposes or to purchase, renovate, improve or refinance credit that has been used in relation to residential property for investment purposes".[21] These different requirements and terminology create uncertainty when applying the definition of "retail client" to credit products for the purposes of DDO.

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[15] Other than a traditional trustee company service or superannuation trustee service, general insurance product superannuation product or an RSA.
[16] Section 761G(12) *Corporations Act 2001 (*Cth).
[17] The test for a "high-value insured" under regulation 9(1) of the Insurance Regulations, is satisfied where, in financial year a person's Australian operating revenue for the 3 previous financial years is at least $200 million, or the average of their Australian assets for the last 3 financial years are at least $200 million, or the average number of employees is at least 500.
[18] See section 45A of the *Corporations Act 2001*(Cth).
[19] Regulation 7.1.06 of the *Corporations Regulations 2001* (Cth) specifically carves out a credit facility from being a financial product.
[20] The extended definition under Part 7.8A of the *Corporations Act 2001* (Cth) applies the definition of "financial product" that is used in the *ASIC Act 2001* (Cth) to the DDO regime (see section 994AA of the *Corporations Act 2001* (Cth).
[21] Section 5 of the National Credit Code, contained in Schedule 1 of the *National Consumer Credit Protection Act 2009* (Cth).

Under the current regime, we consider that the application of the retail client test to credit facilities is fraught and causes a range of problems. In particular, there is a significant issue where a credit facility may be provided for investment purposes, which is not regulated as consumer credit under the Credit Legislation, but which may be regulated under the extended definition of financial product and is the subject of ASIC's action against Bit Trade at present.[22] This issue does not exist for business credit, which is excluded under both the Credit Legislation and retail client definition.[23] None of the current definitions for "retail client" in the Act either contemplate or cater to credit facilities.[24]

We consider that the current wholesale investor/client tests are not sufficient or appropriate to capture credit facilities for the following reasons:

(a) Product value test

Currently, the product value test is determined on the basis of price or the value of the product. The following prices are specified:

- for the provision of an investment-based product – price or value of $500,000;[25]
- for the provision of a margin lending facility – price of $500,000;[26]
- for the provision of an income stream financial product – price or value of $500,000;[27]
- for the provision of a derivative – value of $500,000;[28]
- for the provision of a contract for difference – this test does not apply;[29]
- for the provision of a foreign exchange contract – value of $500,000;[30]
- for the provision of a non-cash payment facility – price or value of $500,000;[31] and
- for the provision of life risk insurance – this test does not apply.[32]

There is no specific reference to credit facilities. This is relevant not only because none of these categories would apply, such that the product value test can be relied on for credit, but also because there are several categories of product where the test is specified not to apply. Even in this regard, credit facilities are not mentioned. No regard was had as to how to apply the retail client test to credit facilities when DDO and the PIP were introduced using the extended definition of financial product that is tied to the retail client definition.

Moreover, the regulation of credit is generally based on the purpose for which the credit is being used not the amount of credit (i.e. product value). This is because, unlike investment products, where the more the investor can afford to spend, the more resources they have, with credit, the more one borrows, the greater one's debt and arguably the greater the risk / consumer detriment.

Parliament should make it clear if it intends to apply or not apply the retail client test to credit facilities, and if it seeks to apply this test to credit facilities, it should specify a threshold. In our view, the product value test should be amended by regulation to specify that it does not apply to credit facilities and a new credit facility retail client test should be created.

(b) Small business test

The small business test has no utility or application to credit facilities because there have been additional exemptions included under the DDO regime, where a credit facility provided wholly or predominantly for a business purpose is exempt.[33] This is consistent with the Credit Legislation, where credit that is predominantly for a business purpose is not regulated.

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[22] Australian Securities & Investments Commission v Bit Trade Pty Ltd ACN 163 237 634, Amended Concise Statement, Federal Court of Australia.
[23] Regulation 7.8A.20(9)(b) *Corporations Regulations 2001* (Cth).
[24] Section 994AA Corporations Act 2001 (Cth).
[25] Regulation 7.1.18(2) and 7.1.19 *Corporations Regulations 2001* (Cth).
[26] Regulation 7.1.19A(2) *Corporations Regulations 2001* (Cth).
[27] Regulation 7.1.20(2) and 7.1.21(2) *Corporations Regulations 2001* (Cth).
[28] Regulation 7.1.22(2) *Corporations Regulations 2001* (Cth).
[29] Regulation 7.1.22AA(2) *Corporations Regulations 2001* (Cth).
[30] Regulation 7.1.22A(2) *Corporations Regulations 2001* (Cth).
[31] Regulation 7.1.23(2) and 7.1.24(2) *Corporations Regulations 2001* (Cth).
[32] Regulation 7.1.25(2) *Corporations Regulations 2001* (Cth).
[33] Regulation 7.8A.20(9)(b) *Corporations Regulations 2001* (Cth).

(c) Individual wealth test

This test can be applied to credit, however it results in inconsistent outcomes as compared to the Credit Legislation. For example, a client afforded regulatory protections under the Credit Legislation because of the nature of the credit facility they are acquiring (e.g. to acquire a residential property), could still be considered a wholesale investor/client under the Act (because they satisfy the individual wealth test). This means the same client could have protections under the Credit Legislation while at the same time not obtaining any protection under DDO or the PIP. Accordingly, we do not recommend this test be used for credit, and therefore it should be amended to specify it is not available for credit facilities.

(d) Professional Investor test

The professional investor definition includes Australian financial services licensees, APRA regulated entities, trustees of certain funds, listed entities, and exempt public authorities (among others).[34] We are comfortable with this definition applying to credit facilities. Although, the definition does not capture credit licensees, we do not consider that it needs to as there is an exemption for all credit for a business purpose.

(e) Sophisticated Investor Test

It is unclear if the sophisticated investor test in section 761GA of the Act applies to credit products. Under this test, a financial product or service is not provided to a person as a retail client if certain requirements are satisfied, including a requirement to obtain the client's written acknowledgement before, or at the time when the product or service is provided, that the licensee has not provided the client with a product disclosure statement (**PDS**), and any other document that would be required to be provided to a retail client under the Act.[35] While it is arguable that a credit provider can comply with this obligation, because PDSs do not exist for credit products, it is possible that a court would interpret this provision to only apply to financial products for which a PDS might be required, otherwise obtaining the client's acknowledgement that one is not provided is meaningless.

In our view, consideration should be given to how to expand this test to cover credit. For example, the current acknowledgement might be retained for products that are financial products under the Act, while a new written acknowledgement might be created for credit products.

(f) New Credit Test

In our view, section 761G should be amended to insert a new sub-section (7)(e) to create a test specifically for credit facilities. This test should be aligned with the types of credit which are regulated under the Credit Legislation (but without reference to whether it is regulated under the Code – this is because the intent is that DDO and PIP should apply to buy now pay later products, which are credit provided to an individual for a personal, domestic or household purpose, but which are not regulated under the Code). To illustrate our intent, the drafting might look like this:

(7)(e) Where a credit facility:

(i) is a financial product under the definition contained in s994AA(1); or

(ii) meets the definition of "financial product" contained in s1023B of this Act; then

the credit facility will be provided to a person (the debtor) as a retail client where:

(iii) the debtor is a natural person or a strata corporation; and

(iv) the credit facility is provided or intended to be provided wholly or predominantly:

(A) for personal, domestic or household purposes; or
(B) to purchase, renovate or improve residential property for investment purposes; or

[34] Section 9 (***professional investor*** definition) *Corporations Act 2001* (Cth).
[35] Section 761GA(f) *Corporations Act 2001*(Cth).

(C) to refinance credit that has been provided wholly or predominantly to purchase, renovate or improve residential property for investment purposes; and

(v) a charge is or may be made for providing the credit facility; and

(vi) the product provider provides the credit facility in the course of a business of providing credit carried on in this jurisdiction or as part of or incidentally to any other business of the product provider carried on in this jurisdiction.

6. Miscellaneous Financial Risk Products

Holders of "miscellaneous financial risk facilities" in general are classified as retail clients due to the unavailability of some of the wholesale client/investor tests. This is relevant for particular industries, specifically discretionary mutuals and discretionary risk products, which are alternative risk management vehicles for general insurance. This results in these clients almost always being treated as retail clients, unless the mutual participants meet the requirements of the business test or the professional investor test.

An example of a discretionary mutual where the members are treated as retail, but that in our view should be treated as wholesale investors/clients, is a farmers mutual. Such a mutual provides farmers with access to an alternative risk transfer vehicle which is substitutable for crop insurance. An insured under a crop insurance policy would be wholesale, but a participant in a farmers mutual for equivalent protection would be a retail client.

In our view, because this product is an alternative to general insurance, it would make more sense to replicate the general insurance wholesale investor/client test contained in s761G(5) of the Act, to align similar outcomes across the alternative products.

7. Self-managed superannuation funds

The application of the individual wealth test to superannuation funds that are self-managed superannuation funds (**SMSFs**) is unclear.

Regulation 7.6.02AB provides that a company or trust controlled by a person who meets the individual wealth tests is also itself a wholesale client.[36] An SMSF corporate trustee arguably cannot be "controlled" due to the requirement for all members of an SMSF to be involved in its operation and management, and this has resulted in disparate treatment in the industry. We are aware of the following approaches:

- a licensee will treat an SMSF corporate trustee as a wholesale client if *any one* SMSF member meets the individual wealth test; or
- a licensee will only treat an SMSF corporate trustee as a wholesale client if *all* SMSF member meets the individual wealth test.

An alternate interpretation could be that the individual wealth test does not apply to an SMSF corporate trustee because it is not capable of being controlled by any one member. We have not seen this interpretation being used in practice.

Accordingly, the correct application of the individual wealth tests to SMSF corporate trustees requires clarification. To the extent that we have a view, we do not support the conclusion that the SMSF corporate trustee can be treated as wholesale because any one member meets the individual wealth test.

8. Strata insurance

[36] Regulation 7.6.02AB *Corporations Regulations 2001* (Cth).

Our clients in the strata insurance industry require clarification around the application of the wholesale investor/client test as it applies to strata corporations.

The test that applies to general insurance is contained in section 761G(5) of the Act and is predicated on:

- the insurance being acquired by an individual or small business; and
- the insurance being one of the designated classes of insurance.

This test presents challenges for two reasons:

- the strata insurance policy is usually acquired by the strata corporation, which is not an individual, but is also not a "business" of any kind, as strata corporations are not running any kind of business, they are just an aggregated corporate entity representing the individual lot owners within the strata scheme. Arguably, therefore, they cannot be a retail client – but at the same time, the Act does not seem to contemplate the categorisation of a corporate entity that is not a business under the wholesale investor/client tests; and
- strata insurance will always fall within the designated classes of insurance, where it is any kind of residential strata building, because it will include a home building component. However, this may not always be appropriate for large-scaled, mixed-used strata schemes, for example, Barangaroo Tower.

In some States, there is an argument that strata insurance is not a financial product at all.[37] However, this exemption does not apply to all States, and even where it does apply, strata insurance providers are reluctant to rely on the exemption, and therefore clarity is needed on whether strata corporations should be classified as retail or wholesale.

To resolve this issue, we recommend that clarity be provided on whether strata corporations are intended to be caught by the retail client definition in respect of the use of language relating to individuals and small businesses. If strata corporations are intended to be caught, it may be necessary to amend the drafting of s761G(5) of the Act to read that the person is an individual, or the product is used in connection with a small business, or the person is a strata corporation. If the intention is not to capture strata corporations, it would be useful to amend the definition of "small business" in s761G(12) of the Act to note that a strata corporation is not considered to be a business at all.

We also recommend that an explicit exclusion be included in respect of strata insurance that is acquired for use in connection with a large-scale strata scheme of a mixed use for example, mixed apartments, hotel, and retail/commercial spaces. We consider it appropriate for such strata corporations to be classified as wholesale investors/clients because it is likely that a large insurance broker will be involved and can give advice to the stakeholders on the appropriateness of the insurance program and invariably, the scheme will include lot owners who are developers and similarly who will not need a PDS to assess the insurance. Such strata schemes will also seek to access insurance markets where the insurer only services wholesale clients. This means that by treating all strata corporations as retail clients, it prevents these large-scale strata schemes from accessing those insurance markets.

[37] See '*Is Strate Insurance a Financial service?*', Hamilton Locke, 6 December 2022.