Submission
Managed Investment Schemes – regulatory framework

30 January 2024

Submission

1 Addressee

By email

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2 Background

2.1 Clyde & Co is a leading international law firm. With deep experience in financial services regulation, we assist domestic and global financial institutions with their most sensitive and technically complex mandates.

2.2 We have extensive experience advising clients in the funds management, crowd-sourced funding and digital asset sectors. We are one of the world's leading firms in the digital asset tokenisation (see below) space for equity products. We have sought our clients' feedback on the proposed changes over the last 6 months.

2.3 One piece of specific feedback has been consistent, and is not covered in the published submissions; we wish to pass this on to Treasury, which we think that had numerous successes together with the Assistant Minister for Financial Services Stephen Jones e.g., the passing of Financial Accountability Regime, and consultation on digital assets.

2.4 We are motivated to see that success continue for the benefit of all Australians.

3 Sophisticated Investors / Tokenisation

3.1 The financial test for sophisticated investors has not changed in decades; it needs to change as the Government has identified, but simply raising the threshold to $450,000 in income or $4.5M in net assets is not the singular answer.

3.2 It will damage the Treasury / Government's phenomenal efforts in the digital assets space. This is not something that the submissions Treasury has published delve into in any meaningful way, and is why we are compelled to write this submission – denying access to tokenised assets will prohibit a significant number of would-be investors from putting money into early-stage start-ups as angel investors, or investing in venture capital. It will particularly damage Millennial and Gen Z investors, who do not have the means to put up substantial capital.

3.3 Tokenisation of financial products refers to the process of representing ownership or rights to financial assets as digital tokens on a blockchain or distributed ledger. This approach leverages blockchain technology to create a digital representation (i.e., a token) of real-world financial assets, making them highly divisible, transferable, transactable real-time, and programmable. Investors can gain access to highly lucrative financial products at a fraction of the cost of the usual buy in price.

3.4 Fractionalised financial products e.g., units in managed investment schemes permits enhance the transferability and liquidity of assets which would otherwise be illiquid or inaccessible by retail investors. It allows for the democratisation of investment for those who do not have the capital to investment in well-constructed investments, with high initial investment thresholds. It also empowers individuals to build diversified portfolios therefore diluting investment risk, and fosters financial inclusion by circumventing traditional barriers to entry.

4 Proposed solution

4.1 Our position is more nuanced than some of the consultation papers we have considered. We take no issue with the raising of the threshold, and understand ASIC and consumer groups' position in this regard.

4.2 Mr. Hennessy has previously publicly noted inherent concerns with the threshold in the Australian Financial Review in January 2020[1] i.e., an annual salary of $250,000 does not mean that someone is a sophisticated investor. It is an unusually blunt means of assessment. Sophistication is specifically skills based, which many clever medicos, engineers and academics earning over that threshold and who struggle with tax and financial planning would agree with us on.

4.3 Additionally, this would potentially preclude 15.2% of all SMSFs between $2M and $4M[2] from investing as a wholesale investor. According to statistics currently available to us, as of March 2023, the total SMSF AUM is $889.5B.

4.4 Our solution builds on existing regulatory infrastructure, and addresses the core issue – skills. There should be an exemption for the asset threshold for those who:

(a) undertake an ASIC-approved education course, similar to ASIC RG 146. This has the ancillary benefit of improving Australian's financial literacy, which is an enduring concern given the reduction of qualified financial advisers / limited financial services regulation practitioners / prevalence of finance scams in the market. Treasury has an opportunity to '*kill* <u>*multiple*</u> *birds with one stone*' and cross-link its macro objectives; or

(b) can demonstrate sufficient ASIC-approved time in a vocation or educational qualification which lends itself to investment, operations, risk, compliance, analysis or legal expereince i.e., so they can undertake their own risk assessment of products. This builds on the existing tests for Responsible Managers, and the AFSL B1 Proofs that ASIC requires. We have recevied feedback from our clients that it would also be benficial for the investors to receive compulsory training to be categorised as sophisticated investors. This does not need to occur overnight, however this is a suitable direction that can ensure the financial literacy of a sophistcated investor. The issuer / distributor could verify this information, and which ASIC can set criteria for the content / audit and place penalties on the organisation for non-compliance; or

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1 'Wealthy clients are no longer sophisticated investors' (AFR) 6 January 2020.

2 Who control 31.9% of all AUM attributed to the SMSF sector, according to statistics published by ATO in September 2023.

(c) complete a robust test by the issuer / distributor of the product, which ASIC can set criteria for the content / audit and place penalties on the organisation if it does not comply. This builds on and can be intergrated within the Design & Distribution Regime and, while naturally a burden on the issuer / distributor, many will undertake this action in order to sufficiently demonstrate that their investors have the deep understanding of the products they propose to obtain to ASIC and indeed themselves; and

(d) the above could be combined with confirmation in writing to opt out of the current protections offered to retail investors in an active and informed way. Accordingly, the skills threshold would be met / there would be informed consent.

4.5 Other exemptions which easily build on existing ASIC infrastructure, and which can be used to categorically prove that the investors have the knowledge and risk awareness to invest in potentially riskier investments, can be built.

4.6 Australia already has a poor record of attracting investor start-up capital as we:

(a) are a high-tax jurisdiction;

(b) are a high wage jurisdiction;

(c) are separated from major markets by geography e.g., the US and UK;

(d) the managed investment scheme is not aligned with global vehicles, and unfamiliar to many international investors;[3]

(e) younger Australians have minimal capital, given stagnant wage growth; and

(f) financial advisers have been reduced / oft-times have limited product lists.

4.7 This nuanced approach will assist younger Australians, and be consistent with the Government's approach to the regulation of digital assets. The real thrust in that space, in our view, will be in the tokenisation of equity instruments given all the structural benefits e.g., voting rights, fractionalisation, and cost savings they represent.

5 Conclusion

5.1 UK Finance recently estimated that digital assets could represent as much as 10% of the global funds market by 2030, equivalent to a value of between \$4 - \$5 trillion.[4]

5.2 Please do not cut out younger and less economically able investors from this market. It will serve to further concentrate wealth in older generations.

5.3 We will be a global outlier, it will negatively impact these individuals' ability to generate wealth and achieve the Australian dream, it cuts against this Government's impressive work in the regulation of digital assets and it is entirely avoidable with a few tweaks to existing legislation and ASIC constructs. Those

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3 Which is why Australia created the CCIV regime; it is proving slow to be adopted.

4 UK Finance: Unlocking the Power of Securities Tokenisation July 2023.

tweaks will meet the regulators' needs for secure markets, and oversight / enforcement over entities.

5.4 We welcome any further opportunity to engage with policymakers and regulators on this reform. Please contact Liam Hennessy, Partner on liam.hennessy@clydeco.com.

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