

29 September 2023

Dear Treasury,

Please see below our submission to the ‘Review of the Regulatory Framework for Managed Investment Schemes Consultation Paper’ dated August 2023.

Australian Secure Capital Fund Ltd, established in 2016, is a Brisbane based pooled mortgage fund manager which manages over \$200m as the Responsible Entity to three registered Managed Investment Schemes, ASCF Premium Capital Fund (ARSN 637 973 409), ASCF Select Income Fund (ARSN 616 367 410), and the ASCF High Yield (ARSN 616 367 330). It also acts as Trustee to one unregistered wholesale Managed Investment Scheme, ASCF Private Fund.

## Chapter 1: Wholesale Client Thresholds

### 1.5 Questions for Consideration

*Question 2: Should the financial thresholds for the new assets and/or gross income in the individual wealth test be increased? If so, increased to what value and why?*

#### **Submission**

We consider the current financial thresholds for the individual wealth tests are adequate.

On the basis that high gross income is intended to correlate with an individual’s financial knowledge and experience, it follows that such an individual would limit gross income in their personal name, preferring to retain excess income in more tax effective company, trust or superannuation structures or salary sacrifice arrangements.

As a consequence, we do not believe it necessarily follows that increasing the income test beyond \$250,000 would have the desired effect of disqualifying inexperienced investors.

*Question 3: Should certain assets be excluded when determining an individual’s net assets for the purposes of the individual wealth test? If so, which assets and why?*

#### **Submission**

We consider the family home and superannuation are suitable for inclusion in the individual wealth test. We note significant barriers to entry in the real estate market (that is, high real estate prices) and limits on superannuation contributions during the accumulation phase both contribute to the principle correlating net wealth with business experience and knowledge.

*Question 4: If consent requirements were to be introduced:*

*(a) How could these be designed to ensure investors understand the consequences of being considered a wholesale client?*

### Submission

We have no objection to the introduction of a written consent requirement (outlining the consequences of being treated as a wholesale client) to accompany both the sophisticated investor test and the individual wealth test in accordance with the Quality of Advice Review as set out on page 19 of the Consultation Paper.

*(b) Should the same consent requirements be introduced for each wholesale client test (or revised in the case of the sophisticated investor test) in Chapter 7 of the Corporations Act? If not, why not?*

### Submission

As a general point, it is important to ensure regulatory intervention does not stifle innovation and diversity within the managed funds industry resulting in limited investment choice for consumers.

For example, when reflecting on the following statement from Consultation Paper 2.1 Scheme Investments, paragraph four:

*“The inquiry suggested considering the appropriateness of the regulatory settings to **protect** consumers from undue financial risk, due to the apparent ease with which schemes that are **novel**, risky, **illiquid**, or speculative can be registered and sold in Australia”* (emphasis added).

We would observe an inherent assumption in this statement that retail investors are, in general, vulnerable.

However, Australia benefits from a mature and sophisticated professional financial advice industry and a largely educated retail consumer, both of whom rely on true-to-type asset funds to construct well-diversified and risk managed investment portfolios. We define a true-to-type asset fund in this context as a fund that gives direct exposure to a particular asset class, such as property or mortgages.

Whilst imposing conditions on “certain scheme arrangements” may have merit in relation to overly complex and unusual schemes, it is important that such conditions do not overflow to true-to-type funds resulting in restricted fund design, diluted / homogenised investment funds and limited choice and outcomes for consumers.

Further we reflect on the following statement from Consultation Paper 2.1 Scheme Investments, paragraph five:

*“Other jurisdictions have incorporated conditions for certain scheme arrangements that generally ensure more diversified and liquid options are offered to retail clients (see Box 4)”*.

Again, we are concerned that regulatory intervention may impose restrictive liquidity conditions at the fund level leading to diluted / homogenous managed funds. This makes it difficult to achieve diversification at the investment portfolio level because funds are less likely to be true-to-type.

For example, assume a financial advisor is designing an investment portfolio comprising 40% equities, 20% property, 20% fixed income and 20% cash. The advisor has identified mortgage funds as meeting the investment need for fixed income. In this example it is likely the liquidity of the mortgage fund is less important than the target distribution rate because the liquidity objective is already met in the overall portfolio construction by holding 20% cash.

As a general observation, liquidity in and of itself should not be misconstrued as automatically “protecting” retail investors. For example, equity and derivative schemes typically offer excellent liquidity however are considered higher risk than property and mortgage schemes.

We further discuss particular liquidity issues as they relate to mortgage schemes in answers to “Chapter 5 - Right to withdraw from a scheme” below.

## Chapter 5: Right to Withdraw from a Scheme

### 5.4 Questions for Consideration

*Question 17: Is the definition of liquid assets appropriate? If not, how should liquid assets be defined?*

#### **Submission**

Following from our general reflections at question 5 above, we consider liquidity in the context of mortgage funds as a relevant case in point.

From our perspective, a well-designed “**novel**” mortgage fund balances fixed investment terms with the underlying mortgage loan terms, matching the liquidity requirements of both parties.

Such innovative fund design is facilitated through current legislative requirements including the current definition of liquidity. It delivers a true-to-type financial product, offering indirect exposure to real estate and meeting a wide variety of investment needs for financial advisors and retail investors.

Adopting the CAMAC suggestion that “*a more objective test of liquidity be introduced such as defining liquid assets as money, bank accepted bills and assets that can reasonably be expected to be realised for their book value within 7 business days*” would be so rigidly restrictive as to make current mortgage funds unviable. It would effectively change the status of mortgage funds from “liquid” to “illiquid”, forcing those funds into the withdrawal offer regime, effectively dismantling the novel “term deposit” mortgage fund design that first emerged over two decades ago. It is difficult to see how such an outcome would provide a net benefit to consumers and their advisors.

We do not consider any change is required.

*Question 18: Are any changes required to the procedure for withdrawal from a scheme? If not, what changes and why?*

#### **Submission**

We do not consider any changes are required.

In particular we note that any changes resulting in the reclassification of a mortgage scheme as “illiquid” and the consequent requirement to adopt.

*Question 19: Is there a potential mismatch between member expectations of being able to withdraw from a scheme and their actual rights to withdraw? If so, how might this be addressed?*

### Submission

The first principle to be addressed here is whether the underlying liquidity of the fund assets are matched with the investors' right to withdrawal. Our response to question 17 above provides an example of how that matching can take place in a well constructed fund and has been well adopted in the mortgage industry for the last two decades.

Whether there is a mismatch between member expectations of being able to withdraw and their actual rights will turn on the fund design itself, including the fund constitution, and the disclosures made in the Product Disclosure Statement and Target Market Determination.

To that end we have found the Design and Distribution Obligations / Target Market Determination provisions very useful in addressing this issue. Our experience is that the additional disclosures in the Target Market Determination complement the Product Disclosure Statement disclosures very well and demonstrably assist the consumer in understanding the attributes of financial products.

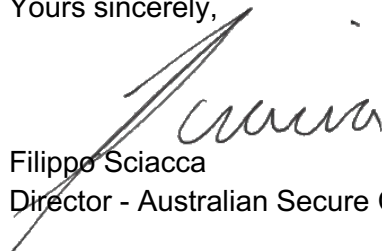
Furthermore, liquidity preservation measures typically built into fund constitutions as a fail-safe mechanism for fund managers work to effectively protect the interests of all scheme members in the event of an unexpected liquidity crisis. Such measures should not be misconstrued as being related to the issue of "mismatch between member expectations" as they are designed to play a particular role in response to a particular unexpected event. Many fund managers and scheme members were equally pleased to have the benefit of these kinds of measures as part of their planning response for impacts arising from the recent pandemic issues.

We are concerned that proposals to restrict liquidity requirements or to amend the definition of liquidity may pose enormous challenges for pooled mortgage funds in circumstances where the industry currently finds itself in a period of stability and regulatory certainty.

In addition, any measures which would require regulated liquidity levels ie: cash or cash like holdings will reduce the overall return to investors as these funds would be unable to be deployed to achieve the targeted returns offered to investors. This would be particularly concerning for mortgage funds such as ours and in particular our investors, noting that we have never had a liquidity issue under the current regime since inception in 2016.

We look forward to hearing the results of the consultation.

Yours sincerely,



Filippo Sciacca  
Director - Australian Secure Capital Fund Ltd.