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NEWS

Small scale offers – have you weighed up your options?

Small scale offers (SSOs) have long been used by trustees and investment managers to lawfully raise capital without adhering to the strict disclosure requirements imposed by the Corporations Act (Act).

Simply put, from an investment funds perspective, the Act allows an unregistered managed investment scheme to accept investments from retail investors without having to issue a PDS. The obvious benefit of SSOs is that capital may be sourced for a fund from retail (and wholesale) clients without incurring the cost and ongoing obligations associated with issuing a PDS.

However, partner Langton Clarke from our Funds Management team warns that SSOs can easily create ongoing concerns and obligations for trustees and responsible entities which may outweigh the convenience.

WHAT IS AN SSO?

Typically, an issuer of interests in a managed investment scheme must issue a PDS to a retail client before issuing them units in the scheme.

Under the Act, provided certain requirements are met, an issuer does not need to issue a PDS where—

- the number of people to whom the issuer has issued financial products does not exceed 20 in any 12-month period, and
- the amount raised by the issuer from issuing financial products does not exceed $2 million in any 12-month period.

The 12-month period in each case is assessed on a rolling basis so, at least at surface level, an SSO seems an attractive method for conveniently raising capital. However, it cuts both ways: monitoring compliance with the law across various financial products over a 12-month rolling window can be difficult for funds that do not have robust compliance reporting and procedures in place.

It is important to note the SSO provisions do not apply separately to each financial product issued by an issuer; it is assessed in aggregate. For example, a trustee entity with several separate funds can only issue interests to 20 retail clients in total across all funds while relying on the SSO provisions.

LICENSING

These provisions do not have any effect on AFSL requirements.

An issuer, relying on the SSO exemption, may not be required to issue a PDS. However, the appropriate AFSL authorisations for the financial services being provided (such as issuing interests in the fund) are still required.

The cost and time investment to acquire an AFSL is significant and the consequences of engaging in a financial services business without the appropriate authorisations are severe, particularly where products and services are provided to more vulnerable individuals, such as retail clients. That means any product issuer relying on the SSO carve-out should ensure they adhere to the AFSL rules.

REGISTRATION AND ISSUING A PDS

The Act provides that, in general, a managed investment scheme operator must issue a PDS to retail clients prior to issuing them units in the scheme.

This may cause problems where an issuer has previously relied on the SSO exemption and either the investor or capital ceiling is breached. In that case, the issuer is required to issue PDSs in relation to the financial product offering which caused the breach and all subsequent financial product offerings (if those offerings caused the breach to continue).

The next domino to fall is the registration of the managed investment scheme: breaching the investor ceiling is also likely to trigger the statutory requirement to register a managed investment scheme.

Registration and issuing a PDS are both time consuming exercises which bring with them their own compliance, disclosure, and reporting requirements.

Our Funds Management lawyers can help you understand the obligations that come with SSOs and help you weigh up the options.

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