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NEWS

Wholesale confirmation – is my fund compliant?

With financiers increasing their focus on due diligence and lending compliance, we are seeing an increasing number of requests from fund managers to provide a 'wholesale confirmation' to obtain senior financing. A 'wholesale confirmation' is a legal sign-off confirming a fund does not have to be registered under the Corporations Act (Act). Funds Management partner Langton Clarke says that leaves fund managers to answer the question, is my fund a wholesale fund?

WHAT IS A WHOLESALE FUND?

A fund does not have to be registered if it is not required under the Act to give a product disclosure statement to each investor. To rely on this exemption, a wholesale fund must only raise capital from wholesale or professional investors who do not require a PDS prior to investing. Frequently, funds fall short on one key verification step for wholesale investors – the accountant's certificate.

WHY IS AN ACCOUNTANT'S CERTIFICATE REQUIRED?

Unless an investor is making an investment of at least $500,000 (or fits within one of the other very narrow exceptions), a wholesale investor must provide an accountant's certificate verifying it meets the requirements under the Act for a wholesale investor, namely—

- the investor has net assets of $2.5 million, or
- the investor has a gross income for each of the last two financial years of at least $250,000.

An investor will only be treated as wholesale if it can provide a compliant accountant's certificate confirming the investor meets at least one of those criteria. Although this may seem like a simple step, audits reveal that in many cases, funds have failed to obtain a compliant accountant's certificate.

COMMON MISTAKES

Set out below are some of the more common mistakes we have observed in our audit of accountant's certificates.

1. **Missing the details of the investor** – Arguably, the most critical feature of the accountant's certificate is that it specifies the person, or the person controlling the entity, making the investment. The accountant's certificate must record the

details of the investor that will ultimately be identified on the register of unitholders in the fund.

2. **Failure to state wholesale investor criteria**– The accountant's certificate fails to state the investor satisfied the wholesale investor criteria or the relevant section of the Act under which the certificate is given.
3. **The certificate was given out of time**– An accountant's certificate must be obtained before the investor subscribes for an interest in the fund and must be provided in the two-year period prior to the date of their investment. In some cases, certificates were too old or were provided after the date the person invested in the fund.
4. **Qualified accountants** – To be a 'qualified accountant' under the Act, the person giving the accountant's certificate must be a member of one of the professional accounting bodies recognised by ASIC. The accountant must also state it is compliant with the ongoing continuing professional education requirements of the professional body. This aspect of the certificate was consistently incomplete, and many were given by investment advisers who are not 'qualified accountants'.
5. **Certificate was not signed or dated** – A surprising number of certificates were not signed by the accountant or dated. An accountant's certificate must not be more than two years old and must be signed by the person giving the certificate.

CONSEQUENCES

Failure to comply may give rise to the following scenarios:

- The fund may be forced to rely on the limited exemptions to disclosure for retail investors and those specific investors will be treated as retail clients. Those exemptions are difficult to satisfy, and some senior lenders may refuse to accept the fund as wholesale.
- A 'wholesale confirmation' is not possible, which means the fund will be in breach of the registration requirement and open to action by not only ASIC, but also investors for failing to comply with the disclosure requirements of the Act.

PRACTICAL STEPS

Some practical steps funds can take to mitigate the risk of non-compliance include:

- Creating an audit register setting out the requirements to verify an individual as wholesale which must be completed for every investor (this will also make the process of obtaining a wholesale confirmation more cost effective in the future).
- Generating a template accountant's certificate for the fund to give to investors as part of the IM or application for each investor to complete as this will give funds certainty that the certificate is compliant (assuming it is completed correctly).

When a fund is established and money is coming in, it is easy for fund managers to overlook this essential step in compliance. We recommend funds set up strong governance practices from the outset to mitigate the risk of non-compliance and a potentially very expensive correction exercise down the track.

WE CAN HELP

If your bank is asking for a wholesale confirmation letter or you need further advice on your fund's compliance, please contact a member of our Funds Management team.

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