



Big bucks bring golden opportunity for 'sophisticated' investor

There are risks but the rewards can be lucrative

NICKI BOURLIOUFAS



ONCE you have a few hundred thousand dollars to invest, your investment world opens up dramatically, with many institutions offering you discounts on fees or greater returns if you can cough up the big bucks. Some of the perks also include being able to access exclusive equity offers or corporate bond offers typically made to institutional investors only.

While companies typically issue capital through share raisings offered to the public with a prospectus, there are some investment offers made only to "wholesale" or "sophisticated" investors that don't require disclosure documents under the Corporations Law.

Such offers include private share placements, pre-float offers usually at a discount to an initial public offering price and private equity investments generally available only to wholesale or institutional investors. You need to qualify as a sophisticated investor to get access to such offers, typically made through stockbrokers or financial planners who have lists of such investors.

To be deemed a sophisticated investor under the Corporations Act, a person must invest at least \$500,000 in a securities offer or have a certificate from an accountant certifying their net asset worth of \$2.5 million or gross income for each of the past two financial years of at least \$250,000 a year.

While in reality a sophisticated investor may be no wiser than a retail investor, the law deems them to have greater understanding of financial markets given their asset level. They are assumed to be able to assess risks and make quick financial decisions so they don't receive the same level of protection as retail investors, whom the law assumes need more protection through a prospectus, which discloses the risks of investments.

"While such investors do hold a certain level of assets, that doesn't mean they are better informed than any other investor,"

says Giselle Roux, chief investment officer with JBWere. "But a sophisticated investor is believed to be able to make a decision in a relatively short timeframe so they can participate in offers made to wholesale investors."

The law defining a sophisticated investor is under review by the federal government. This follows the global financial crisis, when many "mum and dad" investors, who qualified as sophisticated investors, invested in complex financial products without regulatory protection and made substantial losses.

"The criteria need to be upgraded as I feel the barriers to entry are too low," CMC Markets Stockbroking general manager Damion Ryan says. "This type of investor needs to be made aware there are some risks that they take on by being a sophisticated investor or wholesale client. Therefore the criteria and barriers of entry need to be greater."

So, are such wholesale investment offers any better than retail offers? They typically entail more risk and many include equity offers or complex structured products offering higher returns. But, as with any other investment, investors need to do their homework.

"I don't think that it is necessarily the case that they are more attractive but they tend to be equity products where, for example, they don't have the cashflow or a track record of performance yet," Roux says. "An advantage may be that investors can get access to investments earlier in the cycle, not just those that have been around for some time, for example, in relatively new businesses. But we give our clients real warnings that if something is offering a higher level of return, there must be a higher level of risk."

Pattersons Securities head of corporate finance Aaron Constantine says some wholesale equity offers may offer benefits. When companies need to raise money quickly, for example, they may is-

sue share placements at a discount to a company's listed share price.

"The prime advantage of being a sophisticated investor is their ability to participate in share placements which, from time to time, are attractively priced, as a function of a company's need for money, their circumstances and the relative liquidity of their stock," Constantine says. "Placements can be made inside of three days, compared to a rights issue, which can take six weeks."

A \$5000 limit on individual investments is entrenched in the law, reducing risk for investors. So while you don't need the big bucks to participate in a private share placement, you do need to be classed as a sophisticated investor to participate in the first place.

Warren Skinner, principal and senior adviser with Fintuition, a founding practice of Fortnum Financial Advisers, says taking advantage of such wholesale investment offers can have a positive compounding effect on wealth building.

"Such offers can add additional diversification to a person's portfolio, such as investing in private equity," Skinner says.

"That allows investors to get in at the grassroots level or participate earlier in the investment cycle and make money when a company is in its infancy rather than simply participating in a standard IPO when it hits the market. Generally the people who make the big money when a company lists on the Australian Securities Exchange aren't those who invest along with the masses in the IPO but rather the private equity owners of the company prior to the IPO process."

The perks extend beyond equity offers. Wealthy investors also have the ability to participate in the corporate bond market, known as the over-the-counter debt market, where brokers connect buyers and sellers. That market is strictly limited to those with large sums to invest.

"Buying bonds through the OTC mar-



ket can offer diversification and a whole spectrum of assets with different risk parameters suiting different needs," says Jim Stening, managing director of specialist fixed-interest broking house FIIG Securities. From \$50,000 parcels, his clients are able to access a wide spectrum of corporate bonds potentially offering higher returns than retail investments.

"The big thing about owning bonds directly is that they deliver a cashflow and you can tailor that to your own needs by buying different bond maturities.

"That compares to a managed bond fund, which has control of the income or cashflow, not the individual investor."

Yields also can be higher than retail bonds. "It's a bit like access to the wholesale market and getting the benefit of that access — that is, higher yields and more income over the life of the bond — without margins being taken out by anybody else," Stening says.

"There is more choice of bonds from different issuers and different investment grades in the OTC market, and the more choice you have, the better off you are. There's not a lot of choice with listed bonds so they can be overvalued."

JBWere's Roux says her firm has a minimum investment size of \$100,000 for

corporate bond purchases. While corporate credit is one of the safest asset classes, Roux says diversification is more difficult. "We can cut it down into smaller lines, but for most investors, it isn't accessible."

In terms of clients looking for someone else to manage their money rather than direct investments in assets, wealthy clients often take advantage of wholesale managed funds and fee reductions.

"Those fee savings can be quite substantial because clients get a discount because they are investing in wholesale funds, where minimum investments can be as high as \$1m. But we've seen minimum investments come down in recent years, to average between \$250,000 and \$500,000, because of competitive pressures," Fintuition's Skinner says.

"Once invested, a client might save around 50 per cent of the cost of the fees, which can add up to significant savings."

Stacey Martin, a senior wealth adviser with NAB Private Wealth, says the appeal of a managed fund over direct investments is that an expert is managing a client's money. Clients typically get access to a broader spectrum of assets, both local and global managed funds, with fee reductions typically between 90 and 100 basis points for wholesale fund

investments. If clients don't meet minimum investment requirements, NAB private wealth pools assets between clients, making those wholesale rates available to clients with lesser amounts to invest.

"People are getting more interest in managed bonds, for example, where managers regularly review investment strategies to account for changes in the markets and new risks," Martin says.

"Because the markets have been so volatile, there has been a lot of money invested in cash and term deposits yielding about 6 per cent.

"But now that the cash rate is coming down people are looking at other instruments that can still give a good yield and so people are looking at corporate credit, but the quality of the issuer is key."

Scott Fletcher, head of strategic wealth solutions at Russell Investments, says minimum investment levels in wholesale funds typically average about \$500,000.

"There may be exceptions to that, but that's the typical starting point", with savings on fees starting from about 30 to 40 basis points off retail fees.

He says once an investor can meet the minimum investment level for wholesale funds, then the savings or perks of being wealthy can boost returns.

To be categorised as a 'sophisticated investor' a person must:

- a) Invest at least \$500,000 in a securities offer
or
- b) Have a certificate from an accountant certifying their net asset worth of \$2.5 million
or
- c) Have gross income for each of the past two financial years of at least \$250,000 a year

If they get that, they can access some or all of the following:

-  Private share placements offered at a discount to the shares' listed price

-  Pre-IPO offers usually offered at a discount to the IPO price
-  Private equity funds generally available only to wholesale investors
-  Discounts on managed fund fees from 30 to 40 basis points if investing in wholesale funds
-  The opportunity to buy corporate bonds directly, offering higher yields than retail bonds

