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GUIDANCE NOTE

# WHOLESALE CLIENTS & ELIGIBLE INVESTORS

# Background

Under the Financial Advisers Act 2008 (FAA) and Financial Markets Conduct Act 2013 (FMCA), some investors have been categorised as 'eligible investors' so as to bring clients into the 'wholesale client' category under the FAA and the 'wholesale investor' category under the FMCA. With the repeal of the FAA, and with all financial advice services now being regulated under the FMCA, the definitions of 'wholesale' and 'eligible investors', and the processes for categorisation under the FMCA now apply.

The 'eligible investor' categorisation has been predominantly used to get around the requirements and protections under these acts

that relate to 'retail clients'. A person who does not meet the other definitions to be categorised as 'wholesale', but who has experience and 'know how' in relevant financial matters can certify that they are an 'eligible investor' and be treated as a wholesale client.

The level of regulation under the FMCA is significantly higher for retail clients compared to wholesale clients – more protection is provided to clients and investors who are considered financially less sophisticated (retail clients) compared to those who are considered financially savvy (wholesale clients).



## Current position - post 15 March 2021

From 15 March 2021, the FAA was repealed and now all financial advice services are regulated under the FMCA which has undergone significant amendment. The amended FMCA has a new Schedule 5 which introduces a new definition of 'retail client' and 'wholesale client' and sets out the duties that apply to retail and wholesale clients.

The eligible investor category still remains, but with the advent of new duties and 'good conduct' obligations under the FMCA, there are additional factors that must be considered in relation to eligible investors.

# Retail clients, wholesale clients and eligible investors

## Retail clients

### Retail clients are defined in Clause 3, Part 1, Schedule 5 of FMCA

A person is a retail client in relation to a financial advice service or client money/property service if they are not a wholesale client.

## Wholesale clients

### Wholesale clients are defined in Clause 4, Part 1, Schedule 5 of FMCA.

A person is a wholesale client in relation to a financial advice service or client money/property service (unless a person has opted out) if the person:

- a. is an investment business
  - i.e where the client's principal business is investing in financial products, acting as an underwriter, providing a financial advice service or client money or property service, trading in financial products on behalf of other people, or where the client is a registered bank, NBDT, licensed insurer, manager of a licensed registered scheme or DIMS, licensed derivatives issuer or a financial adviser
- b. meets investment activity criteria
  - i.e during last 2 years, the client has owned a portfolio of \$1m+ of specified financial products. See clause 38<sup>1</sup> for additional examples.
- c. is 'large'
  - i.e where the client has net assets or turnover of \$5m+ on the last 2 balance dates
- d. a government agency
- e. in the business of being a product provider and is receiving financial advice services in the course of that business
- f. an eligible investor in relation to the service
  - a person who certifies to having certain experience in the transaction/service that allows them to assess the merits of the transaction/service, their own information needs and the adequacy of the information provided to them.
  - See further information on eligible investors and eligible investor certificates below.

As shown by the above definition, there are many different categories of wholesale client. In some cases, clients are automatically deemed to be wholesale (e.g. people with assets and turnover above certain thresholds, or people working within the financial services industry.) The 'eligible investor' category allows for a person who does not meet the described thresholds or definitions to be categorised as a wholesale client if they certify to having previous experience and 'know how' in the matter.

<sup>1</sup> Financial Markets Conduct Act 2013, sch 1 cl 38

## Eligible investors

### Eligible investors are defined in Clause 41, Schedule 1 of FMCA.

Under the FMCA, clients may still sign eligible investor certificates to be categorised as wholesale clients. **However, it is important to note the following points:**

1

The thresholds for 'wholesale clients' are higher under the FMCA than they were under the Financial Adviser Act 2008. Under the FMCA, a person must have larger investments/ transactions in the past 2 years to have eligible 'investment activity' and must have higher net assets/turnover to be deemed 'large'.

This means that there will be less 'wholesale clients' under FMCA, by virtue of them being 'high net worth individuals'. This is intentional. The government wants to ensure that as many people are given protection as 'retail clients' under the FMCA as possible. Many 'high net worth individuals' do not have significant experience or understanding about financial matters and should be treated as retail clients to increase the likelihood that a good outcome is achieved for that client.

2

The 'good conduct' obligations of FAPs, financial advisers and nominated representatives requires that they act in a way that ensures 'good outcomes' for the client. If a person is technically categorised as a wholesale client, but you have reason to believe that the client is not 'financially sophisticated' and not in a position to assess the merits of the transaction/service and their own information needs in relation to the transaction/service, then you have a responsibility to act in a way to ensure a 'good outcome'. This means that you should treat the client as a retail client, even if they technically satisfy the wholesale client definition. If it will increase the likelihood of a 'good outcome' you should ensure they understand the scope of the service and receive the disclosure information that you would provide to retail clients.

3

There are large penalties if a client signs an eligible investor certificate and certifies that they have the required experience when in fact they do not. There are also severe penalties if a financial adviser signs and confirms an eligible investor certificate for a person, or where they encourage or advise a person to sign an eligible investor certificate if they know that the client does not have the experience that they are certifying to.



## Differences between wholesale and retail clients

Typically the difference between wholesale and retail clients relates to the level of understanding and experience in financial matters.

Wholesale clients are treated differently under the FMCA and are afforded lower protections because they typically have significant experience in investing and financial matters. To treat them in the same way as you would treat a 'retail client' would be time consuming, cumbersome, and not provide them with any additional benefits or ability to make an informed financial decision.

Conversely, every day 'mum and dad' type clients (retail clients) generally have very little experience with financial matters and rely on the financial adviser and the advice process to provide information about the process and relevant risks and consequences to enable them to make an informed financial decision.

The differences in the way that retail and wholesale clients are treated stem from this basic assumption as to the differences in their financial experience and knowledge.

**Disclosure:** One of the main differences in treatment between retail and wholesale clients relates to the provision of disclosure. Under the FMCA, FAPs and those providing advice under them, must provide certain information to retail clients when they provide financial advice. This information must be provided to retail clients to enable them to make informed decisions about the FAP/adviser and whether to seek, obtain or act on advice from them. This information does not need to be provided to wholesale clients.

**Duties that only apply to retail clients:** There are certain duties under the FMCA that only apply if you are providing regulated financial advice to retail clients. These duties relate to the competence, knowledge and skill that the person advising you must have, and the duty of the adviser to comply with standards of ethical behaviour, conduct and client care set out in the Code of Professional Conduct for Financial Advice Services (The Code). Under the Code, when you provide advice to a retail client, you must give advice that is suitable to the client, and also ensure they understand the financial advice you provide, along with its scope. These duties do not apply to the person who provides financial advice to a wholesale client.

**Duties that apply to both retail and wholesale clients:** Most of the duties in the FMCA applicable to those providing regulated financial advice apply irrespective of whether the advice is being provided to wholesale or retail clients.

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### **The FMCA duties are:**

- s431K- Duty to give priority to a client's interests
- s431L – Duty to exercise care, diligence and skill
- s431N – Duty relating to an offer that contravenes the Act or regulations
- s431O – Duty to make prescribed information available (Note: certain disclosure regulations pursuant to this section only apply to retail clients)
- s431P- Duty not to make false or misleading statements and omissions
- s431Q – Duty for persons engaging others to give advice to ensure those persons' compliance with duties
- s431R – Duties of persons who engage nominated representatives
- s431ZA- s431ZB - Conduct obligations applying to regulated client money or property services (including the obligation to exercise care, diligence and skill)

### **Good conduct obligations**

- Good conduct underpins the FMCA and applies to those who provide financial advice to both wholesale and retail clients. Good conduct focuses on clients and achieving consistently good outcomes for them.
- This means that FAPs and those providing regulated financial advice, along with providers of financial services need to consider how their conduct supports clients and provides them with the necessary information and understanding so they can act in their own interests and make good decisions.
- This means that if a person, who is technically a wholesale client because they won lotto or inherited a large sum, is not financially experienced and does not have the financial literacy and understanding that the FMCA deems them to have by virtue of their categorisation, **you may still have an obligation to treat them as you would a retail client, and provide them with disclosure and comply with the ethical standards under the Code.**

## How to onboard wholesale clients and eligible investor clients

An important part of the client onboarding process is undertaking appropriate client due diligence. This is done by talking with the client to get an understanding of their intention and what they are wanting to achieve and getting an understanding of their experience with financial products and services. Early on in the process, it is important to identify if the client is a wholesale client. Strategi sells a range of templates, including a 'Wholesale client checklist' that will help advisers to determine whether a client meets the definition of wholesale client. If you determine that a client is a wholesale client, both by definition under the FMCA and also after determining that to treat them as such would not be in breach of your good conduct obligations, then you can treat them as such.

### Complete 'Wholesale Client Checklist'

We suggest advisers and FAPs use a checklist during the client onboarding process to categorise a client as wholesale or retail. Advisers should complete this checklist and in the relevant space on the form, describe the supporting evidence that they are relying on to categorise the client as either wholesale or retail.

If the adviser determines that the client is a wholesale client, the adviser must ensure they fully discuss with the client (individuals and entities) the implications of this.

If the adviser determines that the client is a wholesale client based on their net assets and turnover, they should obtain evidence of this. As a minimum this should include the financial statements for the last two completed accounting periods plus a signed letter from the client confirming that the net assets or turnover has not fallen below the minimum requirement since the end of the financial period for which the financial statements have been produced.



If the adviser is unsure whether the relevant client satisfies any of the criteria to be categorised as 'wholesale' they should refer to the relevant clause of the FMCA (either clause 4 Schedule 5, or clauses 37-41 Schedule 1) to confirm the exact wording of the Act. If they are still unsure, they should seek assistance from another person to determine whether the client satisfies the definition of wholesale. If in doubt, you should treat the client as a retail client because the penalties for treating retail clients as wholesale clients can be high.

### Eligible investor

If the client has not signed an eligible investor certificate

If, while completing the checklist to determine whether the client meets the definition of 'wholesale', you determine that the client satisfies the description of an 'eligible investor', but they have not signed an eligible investor certificate, you may discuss the possibility of this with the client.

- **NOTE:** There are penalties if you encourage, persuade, cause or advise a person to sign an eligible investor certificate when you know that it is false or misleading to do so. You may be liable to a fine not exceeding \$50,000. Additionally, if a client signs an eligible investor certificate, knowing that it is false or misleading in a material way, they may be liable to a fine not exceeding \$50,000.

You cannot rely on the client being an eligible investor and treat them as a wholesale client until they have signed this certificate and it has been certified by an authorised person.

- **NOTE:** In many cases, you (as an adviser) **will not** be able to sign and confirm the eligible investor certificate for the client. They will need to see a different financial adviser, operating under a different FAP licence, or a lawyer or accountant to have the form signed.
- This is because if you work for the FAP/ DIMS provider/product provider/offeror that is seeking to rely on the eligible investor certificate, you will be an 'associated person' if you 'are accustomed to acting in accordance with the wishes of' the FAP/DIMS provider/product provider/offeror.

#### If the client has signed an eligible investor certificate

If, while completing the checklist to determine whether the client is a wholesale client, you establish that the client has already signed an eligible investor certificate, you need to determine whether you can rely on the certificate. Strategi also sells a '*When can I rely on an Eligible Investor*

*Certificate Checklist*' template. Advisers can work through this checklist to determine whether they can rely on that eligible investor certificate.

If, upon completing this second checklist, the adviser is satisfied that the eligible investor certificate is valid and they are entitled to rely on it to treat the client as wholesale, they should attach the completed '*When can an adviser rely on an Eligible Investor Certificate Checklist*' to the '*Wholesale Client Checklist*'. If you have any supporting evidence to support your conclusion that you can rely on the certificate, describe this in the checklist.

- **NOTE:** As an adviser, you have good conduct obligations that require you to focus on 'good outcomes' for the client, whether they are deemed to be an eligible investor/Wholesale client or not. This means that if you think (despite being an eligible investor) that the client will be in a disadvantaged position in terms of their knowledge and understanding of the risks and consequences of their actions if they do not receive relevant disclosure information, you should provide it to them regardless.







## What does an adviser need to do before signing an eligible investor certificate?

If a client or person asks you as an adviser to confirm their certification on an eligible investor certificate, you must consider the following prior to completing and signing the certificate:

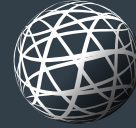
1. Satisfy yourself that the investor is sufficiently advised of the consequences of the certification, e.g. you may inform the investor they will not receive certain documents such as disclosure documents, and that the law will impose fewer obligations and duties on the FAP/financial adviser/offeree/provider, and prepare a file note appropriately recording that discussion with the investor;
2. Ensure the certification is correct, and that you are not required to undertake further investigation, or obtain further information, relating to determining whether or not the certification is correct;
3. Not be an associated person of the FAP, financial adviser, nominated representative, offeror or provider that may seek to rely on this certificate when they provide advice to the client.
  - a. You cannot sign a certificate for a client if you, or the company you are employed by/contract to intends to provide the advice/service/ transaction that the eligible investor certificate relates to and is being signed in relation to.
4. Not have been the financial adviser to the person/FAP/offeree or provider that is providing the relevant advice/transaction/service to the client within the last 2 years.



## Strategi templates

Strategi sells a range of templates to assist advisers and businesses when they deal with wholesale clients and eligible investors. The following templates are available for purchase:

- Wholesale client checklist (to help determine whether a client is a wholesale client);
- When can an adviser rely on an Eligible Investor Certificate checklist? (to help determine whether an eligible investor certificate can be relied on);
- Eligible investor certificates (for financial advice services or client property or money services, DIMS and offers of financial products).



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For more information about the contents of this article, or for advice or guidance in implementing its contents, contact:

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